

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 9A CS Hurricane Preparedness and Insurance  
**SPONSOR(S):** Bogdanoff and others  
**TIED BILLS:** **IDEN./SIM. BILLS:**

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Jobs &amp; Entrepreneurship Council</u>	<u>14 Y, 0 N, w/CS</u>	<u>Callaway</u>	<u>Thorn</u>
2) <u>Policy &amp; Budget Council</u>	<u></u>	<u>Langston</u>	<u>Hansen</u>
3) <u></u>	<u></u>	<u></u>	<u></u>
4) <u></u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

The bill contains several provisions designed to allow more entities to pool their risks or self-insure for property insurance and provides guidelines and restrictions for such. New entities allowed by the bill to self-insure are:

- alliances of Florida-licensed hospitals;
- non-profit corporations;
- 10 or more associations of condominium associations, cooperative associations, homeowner's associations, vacation and timeshare associations, and mobile home park lot tenant associations; and
- less than 10 community associations if the group formed is non-profit and meets other statutory requirements.

The bill reduces the amount of capital insurers who write only property insurance covering manufactured homes must contribute to participate in the Insurance Capital Build-Up Incentive Program and gives priority for the Program funding distribution to those insurers if the Program funds are insufficient to allow all applicants to participate.

The bill provides clarification to current law that Florida Insurance Guaranty Association (FIGA) is authorized to use its emergency assessment directly to pay claims of insolvent insurers. The bill gives the Insurance Commissioner discretion whether to allow an insurer who purchases reinsurance from an alien reinsurer to receive credit on their financial statement for reinsurance purchased. The bill suspends the implementation of flex rating for two years.

The bill makes the following changes to Citizens Property Insurance Corporation (Citizens):

- restricts eligibility for property built within specified distances of the Coastal Construction Control Line.
- abolishes the current Citizens Board and requires appointment of a new Board.
- requires Citizens to offer monthly premium payment plans.
- removes the Board's discretion to approve an exception to the 10-day waiting period for real estate closing.
- requires Citizens' rates to be actuarially adequate, removes the statutory provisions requiring the rates to be non-competitive with the voluntary market, removes the statutory requirement that Citizens include the cost of private reinsurance in its rates whether or not it purchases private reinsurance, and changes the probable maximum loss (PML) requirement for high risk account rates from a 70-year PML to a 50-year PML transitioning to a 100-year PML.
- rescinds the Citizens' rate filing that went into effect on January 1, 2007 except for rate filings which reduced rates and for one year (2007), freezes Citizens' rates to those that were in effect on December 31, 2006.
- creates the Task Force on Citizens Property Insurance Claims Handling and Resolution.
- directs the Department of Financial Services (DFS) to review how Citizens' agent commissions are set and to make recommendations regarding standards to justify agent commissions.

The bill transfers all commercial non-residential property policies from Citizens to the Property and Casualty Joint Underwriting Association (PCJUA) and changes the PCJUA's eligibility requirements. The bill restricts eligibility in the PCJUA for property built within specified distances of the Coastal Construction Control Line.

The bill makes definitional changes to sinkhole provisions in the Insurance Code. The bill is effective upon becoming law.

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

**STORAGE NAME:** h0009Ab.PBC.doc  
**DATE:** 1/16/2007

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

**Provide limited government** – The bill allows additional groups to form self-insurance funds.

The bill directs the Department of Financial Services to review how insurance agent commissions are established and applied for insurance policies in Citizens.

The bill creates the Task Force on Citizens Property Insurance Claims Handling and Resolution.

**Ensure lower taxes** -- The bill provides that certain hospital self-insurance funds are not subject to insurance premium tax and provides that certain corporation not for profit self-insurance funds are subject to insurance premium tax at the reduced rate of 1.6%.

**Empower families** – The bill may lower property insurance rates by authorizing the Office of Insurance Regulation to waive or lower deposit requirements for insurers if such authorization results in more alien reinsurers writing reinsurance for Florida.

The bill amends the law relating to Citizens which potentially will lower rates for its customers. The changes include allowing Citizens rates to be competitive and not requiring the cost of reinsurance to be included in the rates.

The bill rescinds the Citizens' rate filing that took effect January 1, 2007 and directs refunds to policyholders who have already paid the higher rates.

#### B. EFFECT OF PROPOSED CHANGES:

##### The 2004 and 2005 Hurricane Seasons

The 2004 hurricane season was destructive for Florida, with four hurricanes causing extensive damage throughout the state. All four hurricanes occurred within a 45-day period beginning August 13, 2004, when Hurricane Charley<sup>1</sup> made landfall as a Category 4 hurricane; followed on September 5 by Hurricane Frances<sup>2</sup>, a Category 2 hurricane. Next, Hurricane Ivan<sup>3</sup> struck on September 16 followed by Hurricane Jeanne<sup>4</sup> on September 26, which were both Category 3 hurricanes. The paths of the hurricanes indicated virtually no part of Florida is immune from hurricane risk. Allegedly, the 2004 hurricanes caused damage to an estimated one in every five homes in Florida.

For the most part, the insurance and reinsurance industry recapitalized after the 2004 hurricane season. That is, the capital lost by primary insurers and reinsurers was replenished. Additionally, the Florida Hurricane Catastrophe Fund (FHCF) was able to pay its share of the losses out of cash reserves and maintain a cash balance to use to pay claims to start the 2005 hurricane season.

However, as the state was still recovering, recapitalizing, and rebuilding from the 2004 hurricanes, the 2005 season began. The 2005 hurricane season was also destructive for Florida, with four hurricanes hitting Florida for the second year in a row.

Hurricane Dennis hit on July 10, 2005 as a Category three hurricane. Hurricane Katrina hit Florida on August 25, 2005. At landfall in Florida, Hurricane Katrina was a Category 1 storm.<sup>5</sup> Although Florida

<sup>1</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL032004\\_Charley.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL032004_Charley.pdf) (last viewed January 3, 2007).

<sup>2</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL062004\\_Frances.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL062004_Frances.pdf) (last viewed January 3, 2007).

<sup>3</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL092004\\_Ivan.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL092004_Ivan.pdf) (last viewed January 3, 2007).

<sup>4</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL112004\\_Jeanne.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL112004_Jeanne.pdf) (last viewed January 3, 2007).

<sup>5</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL122005\\_Katrina.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL122005_Katrina.pdf) (last viewed January 3, 2007).

did not sustain as severe damage as New Orleans, Louisiana; Biloxi, Mississippi and surrounding areas, Hurricane Katrina caused substantial damage in Florida. The next hurricane to hit Florida in 2005 was Hurricane Rita which made landfall on September 20, 2005 as a Category 2 hurricane.<sup>6</sup> Hurricane Wilma made landfall on October 24, 2005 as a Category 3 hurricane.<sup>7</sup> Hurricane Wilma was the costliest hurricane for Florida in 2005.

The following chart illustrates the eight hurricanes' impact on the insurance industry:

### Summary Data by Event and CY

Event	Data as of	Estimated Gross Probable Loss	Claims Reported	Total Loss Claims	Claim Payments Made
Charley	31-Dec-05	\$10,158,404,847	474,771	17,679	\$9,056,703,918
Frances	31-Dec-05	\$7,952,635,936	541,589	14,105	\$7,707,516,393
Ivan	31-Dec-05	\$3,314,847,829	207,718	8,104	\$3,205,437,734
Jeanne	31-Dec-05	\$3,634,646,243	427,633	8,951	\$3,513,823,790
CY2004 Total		\$25,060,534,855	1,651,711	48,839	\$23,483,481,835
Dennis	31-Dec-05	\$297,399,185	52,934	920	\$269,807,639
Katrina	30-Apr-06	\$853,000,053	122,798	3,153	\$725,223,536
Rita	30-Apr-06	\$25,242,545	4,375	167	\$19,447,845
Wilma	30-Apr-06	\$9,659,383,823	975,717	18,853	\$8,848,516,509
CY2005 Total		\$10,835,025,603	1,155,824	23,093	\$9,862,995,529
<b>Overall Totals</b>		<b>\$35,895,560,458</b>	<b>2,807,535</b>	<b>71,932</b>	<b>\$33,346,477,364</b>

Source: Florida Office of Insurance Regulation, Hurricane Summary Data, published August 2006.<sup>8</sup>

This chart illustrates the eight hurricanes' impact on the different lines of insurance. The line incurring the most impact was the homeowners one.

### Event Totals by Lines of Business CY2004 and CY 2005

Data as of 04/30/2006	CY2004 and CY2005 Combined		
	Claims Reported	Total Loss Claims	Claim Payments Made
Commercial Auto Physical Damage	21,958	416	\$126,247,845
Commercial Multi-Peril	138,323	2,712	\$5,641,902,527
Farmowners	2,909	68	\$72,565,576
Fire & Allied Lines	337,614	5,022	\$7,200,947,534
Flood	3,764	6	\$50,572,939
Homeowners	1,582,848	48,472	\$15,869,192,338
Mobile Homeowners	215,696	5,502	\$2,364,824,992
Ocean Marine	217	1	\$4,822,286
Other Lines	72,190	1,887	\$927,831,013
Private Passenger Auto Physical Damage	432,017	7,847	\$1,087,570,314
<b>Totals by Line of Business</b>	<b>2,807,535</b>	<b>71,932</b>	<b>\$33,346,477,364</b>

Source: Florida Office of Insurance Regulation, Hurricane Summary Data, published August 2006.<sup>9</sup>

Insurers' losses from the 2004 and 2005 hurricanes as well as meteorological expectations that the increase in hurricane activity will continue for the foreseeable future have caused both insurers and reinsurers to reevaluate their tolerance for risk as well as the related amount of additional capital they

<sup>6</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL182005\\_Rita.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL182005_Rita.pdf) (last viewed January 3, 2007).

<sup>7</sup> [http://www.nhc.noaa.gov/pdf/TCR-AL252005\\_Wilma.pdf](http://www.nhc.noaa.gov/pdf/TCR-AL252005_Wilma.pdf) (last viewed January 3, 2007).

<sup>8</sup> According to the publication, the information contained in the chart is compiled from data submitted by each reporting entity and has not been formally audited or independently verified by the Office of Insurance Regulation.

<sup>9</sup> According to the publication, the information contained in the chart is compiled from data submitted by each reporting entity and has not been formally audited or independently verified by the Office of Insurance Regulation.

are willing to commit to Florida. Some insurers have added new underwriting restrictions to reflect changes in their exposure tolerance. Others have nonrenewed or cancelled policies. Still others have raised rates.

In addition, the insurance company rating agencies, such as Standard and Poor's and Moodys, have increased the amount of capital insurers and reinsurers must have to keep a favorable rating. Insurers need to maintain favorable ratings in order to ensure future capital contributions by stockholders.

The reinsurance market only partly recapitalized after the 2005 hurricanes.<sup>10</sup> Pricing at the beginning of 2006 for private sector Florida hurricane risk reinsurance increased 50-70% from the prior year and increased another 50-100% on July 1, 2006.<sup>11</sup> Reinsurance rates covering Florida property are expected to lower some in 2007 as no hurricanes hit Florida in 2006, but are not expected to drop to pre-2004 rates. One reinsurance broker believes reinsurance rates for Florida will lower 10-15 percent in June 2007 with capacity increasing by 25 percent in 2007.<sup>12</sup>

**Capacity:** As a result of the hurricane damage in 2004 and 2005, insurance companies are enforcing stricter underwriting standards to limit their exposure in certain high risk areas or limiting types of properties they select to insure. In 2nd Quarter 2006, there were 167 companies writing personal residential coverage in Florida, a significant drop from the high of 225 companies writing personal residential coverage in 1998. The manufactured housing insurance market also has tightened significantly and one in every five detached family homes in Florida is a manufactured home.

The number of companies actively writing property residential coverage has been declining steadily, even prior to the most recent hurricane activity. The market is dominated by five insurers – Citizens, State Farm Florida, Allstate Floridian, Nationwide of Florida and United Services Automobile Association. The number of companies actively writing in the commercial residential market, which includes condominiums and apartment buildings, is declining too.

Although insurance companies have made frequent rate increase filings since the 2004-2005 hurricane seasons, many believe it is not the rates which are inhibiting a growth in capacity because the surplus lines market is also contracting and rates are not regulated in this market. Thus, it appears the private industry may have reached its threshold for risk in Florida's residential property markets.

**Availability:** In theory, availability can be bifurcated into two issues: fewer companies are writing insurance and the companies that are writing have decreased the number of policies they are issuing. From a consumer perspective, less availability creates a considerable problem in a growing economy, which requires a constant infusion of new capital to compensate for the new homeowners entering the state. Some individuals who own their homes have the opportunity to "go bare," while the majority of people have mortgages that require homeowners' insurance.

One symptom of less availability is the increase in the number of policies in Citizens Property Insurance Corporation. Residual markets such as Citizens are often a measure of the "health" of a particular market – an increase in the number of policies in the residual market is a symptom of a troubled market. Regardless of the underlying reasons, there has been a general growth trend in the number of Citizens policies, which has continued through the last two storm seasons.

A market that has absorbed some of the additional need for capacity is the surplus lines market. According to data from the Florida Surplus Lines Service Office (FSLSO), the amount of premium

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<sup>10</sup> The Task Force on Long Term Solutions to Florida's Hurricane Insurance Market report adopted March 6, 2006, page 12. (citing the Reinsurance Association of America); "A Study of Private Capital Investment Options and Capital Formation Impacting Florida's Residential Insurance Market," prepared by the State Board of Administration of Florida on September 19, 2006, page 3.

<sup>11</sup> "A Study of Private Capital Investment Options and Capital Formation Impacting Florida's Residential Insurance Market," prepared by the State Board of Administration of Florida on September 19, 2006, page 3.

<sup>12</sup> Ed Leefeldt, "Reinsurance Broker says Florida prices to fall," Reuters News 4 January 2007 (available from House Committee on Insurance).

collected in 2002 on residential and commercial policies was \$2.2 billion. Based on the most recent data available, as of October 1, 2006, the projected premium for 2006 will be \$4.2 billion, an increase of 88 percent in five years. However, this market is contracting also.

**Affordability:** The recent increases in insurance rates have created serious concerns for policyholders, legislators, and other leaders within state government. Property values and related taxes have escalated. Combined with insurance rate increases, Floridians are having difficulty absorbing these increases in the cost of living.

The Office of Insurance Regulation (OIR) is charged with the review of insurer rate filings to ensure rates are fair, adequate, and do not unfairly discriminate. Florida law does not authorize the Insurance Commissioner to determine whether or not insurance policies are "affordable." With few exceptions, the Insurance Commissioner is given the responsibility to ensure all rates are fair and adequate and commensurate with the risk.

Insurers are precluded from recouping prior losses; therefore, admitted insurers are not permitted to include hurricane losses from the 2004-2005 hurricane seasons in their current rates. In 2006, 52 of Florida's 167 property insurance carriers requested rate increases over 25 percent related primarily to the considerable increase in their cost to purchase reinsurance and the heightened expectations of future losses related to hurricanes (wind losses arising from hurricane loss models). Increases in property values also have contributed to the increase in insurance premiums as have substantial increases in the cost of labor and materials to rebuild after an event.

**Governor's Property and Casualty Insurance Reform Committee:** On June 27, 2006, Governor Jeb Bush issued Executive Order 06-150 creating the Property and Casualty Insurance Reform Committee (Governor's Committee) to study Florida's insurance issues and make recommendations to the Governor, the President of the Senate, and the Speaker of the House of Representatives. The Governor's Committee met eight times throughout the state to obtain testimony about insurance issues facing Florida homeowners and commercial businesses. The Governor's Committee issued a Final Report on November 15, 2006. In accordance with its charge from Governor Bush, the Governor's Committee made recommendations to improve competition and create incentives for private insurance and reinsurance in the areas of residential, commercial, manufactured homes, condominiums/apartments, and government entities; to depopulate Citizens Property Insurance Corporation (Citizens); to reduce the exposure of the Florida Hurricane Catastrophe Fund by substituting private alternatives; to evaluate the preliminary results of SB 1980 including the capital build-up program, mitigation program, private insurance competition and capacity measures, and Citizens' rate changes; and to influence national catastrophe risk management planning.

### **Background of SB 1980**

During the 2006 Legislative Session, Governor Bush and the Florida Legislature worked to address the strained property insurance marketplace. The Legislature enacted Senate Bill 1980 (SB 1980) which provided a myriad of reforms. They included a \$715 million appropriation to Citizens Property Insurance Corporation (Citizens) to offset its 2005 deficit. This funding reduced the anticipated 11 percent premium regular assessment to about 2.5 percent. In addition, the emergency assessment was amortized over a 10-year period. Both actions saved thousands of dollars for Florida's homeowners.

The legislation amended the Florida Hurricane Catastrophe Fund (FHCF or CAT Fund) to require a 25 percent rapid cash build-up factor in the premiums paid by insurers for coverage from the CAT Fund. The bill allowed limited apportionment companies (i.e., companies with \$25 million in surplus or less), for one year only, to buy coverage from the FHCF that would reimburse the insurer for up to \$10 million of its losses from each of two hurricanes above the insurer's retention, or the amount of hurricane losses the insurer must pay before triggering coverage from the FHCF, which is set at 30 percent of the company's surplus. The insurer must pay a rate of 50 percent of the coverage selected (i.e., \$5 million

for the maximum \$10 million in coverage), which is reinstated at no additional charge for a second hurricane.

The legislation created an Insurance Capital Build-Up Incentive Program. The purpose was to provide funding in the form of "surplus notes" to new or existing authorized residential property insurers, under specified conditions. The amount of the surplus note could not exceed \$25 million or 20 percent of total funds available for the program. The insurer had to contribute new capital to its surplus at least equal to the surplus note and had to apply to the SBA by July 1, 2006. The combination of surplus, new capital, and surplus note was required to be at least \$50 million. An insurer had to meet a minimum writing ratio of net written premium to surplus of at least 2:1 for the term of the surplus note. The writings had to be for residential property insurance in Florida covering the peril of wind. The Legislature appropriated \$250 million for the program.

The legislation established the Florida Comprehensive Hurricane Damage Mitigation Program (My Safe Florida Home) within the Department of Financial Services. The program provides for free inspections of site-built, residential property to determine what mitigation measures are needed to reduce vulnerability to hurricane damage. It provides for 50 percent matching grants to encourage single-family, site-built homes meeting eligibility requirements to retrofit. Grants are limited to \$5,000 (for a \$10,000 project) with up to 100 percent grants (\$5,000) for low-income homeowners. The Legislature appropriated \$250 million for the program.

The bill provided some changes to the rating law. It required the Office of Insurance Regulation (OIR) to approve a rating factor that provides an insurer a reasonable rate of return commensurate with the risk of covering hurricane losses, for that portion of the rate for which the insurer has exposed its capital and surplus and has not purchased reinsurance. It placed the burden on the OIR to establish that a rate is excessive for personal lines residential coverage with insured value at \$1 million or more. It required the OIR to reevaluate the discounts offered for homes built to meet the Florida Building Code and to determine the full actuarial value of such discounts. Effective July 1, 2007, for residential property insurance in any areas for which the OIR determines that a reasonable degree of competition exists, an insurer may increase or decrease rates by up to 5 percent statewide average or 10 percent for any territory without being subject to a determination by the OIR that the rate is excessive or unfairly discriminatory (except for unfairly discriminatory rating factors prohibited by law). This may be used once in a 12-month period.

The bill addressed many significant issues related to Citizens. It created what has become known as a glide path regarding Citizens' rates. The glide path sets rates of the high-risk account of Citizens at the 70-year Probable Maximum Loss (PML) for policies issued after March 1, 2007, 85-year PML for 2008, and 100-year PML for 2009. The bill required sufficient Citizens' rates in the Personal Lines Account and the Commercial Lines Account to provide for the procurement of reinsurance, including the CAT Fund, to pay all claims resulting from a 100-year Probable Maximum Loss (PML). This change applies to policies issued or renewed after March 1, 2007. It required use of the public hurricane model as the minimum benchmark for determining windstorm rates for Citizens. It mandated that if any account incurred a deficit, non-homestead property policyholders will be immediately assessed up to 10 percent of premium. If this assessment is not sufficient to offset the deficit, all Citizens policyholders will be assessed up to 10 percent of premium at the time of issuance or renewal. Any remaining deficit is funded by regular and emergency assessments from non-Citizens' insurance policyholders.

The bill substantially revised the oversight, internal controls, and standards of conduct which apply to Citizens employees and board members. It required the Financial Services Commission (Governor and Cabinet), rather than the Office of Insurance Regulation (OIR), to approve Citizens' plan of operation. It required the Executive Director of Citizens to be confirmed by the Senate. It required Citizens to have an internal audit. It required the OIR to do a market conduct examination of Citizens every two years and the Auditor General to conduct an operational audit of Citizens every three years. It mandated competitive solicitation for certain contracts and board approval of contracts of \$100,000 or more. It required the OIR to conduct background checks on applicants for senior management positions. Board

members and senior managers are subject to the code of ethics and financial disclosure requirements applicable to public officials. It prohibited board members and employees from accepting any gift from any person or entity under contract with Citizens or under consideration for a contract. It prohibited Citizens from retaining lobbyists, but allows employees to register as lobbyists. The legislation required a 10-day waiting period for new policy applications. If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application. It allowed Citizens to adopt policy forms that contain more restrictive coverage than provided in the voluntary market. It required insurers writing the non-wind coverage to contract with Citizens to provide claims adjusting services for the wind coverage provided by Citizens in the high risk account. It required Citizens to offer quarterly and semiannual premium payment plans.

Effective July 1, 2011, the legislation makes homes with a combined dwelling and content value of \$1 million or more ineligible for Citizens coverage. It defined "homestead property" to include properties granted a homestead exemption, property with a current written renter lease of at least 7 months, owner-occupied mobile or manufactured homes permanently affixed to real property, tenants coverage, commercial lines residential property (condominiums), or any nonprofit hospital or continuing care retirement community. All other property is considered "non-homestead property." Effective March 1, 2007, non-homestead property is not eligible for Citizens' coverage. The bill provides provisions for a reinstatement approval process if coverage cannot be found in admitted or surplus lines market. An applicant must get four declination letters, three from surplus lines carriers and one from an admitted carrier.

The legislation also addressed sinkhole claim coverage issues which have been significant market drivers in Pasco County and the surrounding Tampa Bay area. It required the Department of Financial Services to certify engineers and geologists to serve as "neutral evaluators" of sinkhole claims disputes. This process would be mandatory, but non-binding, and the costs would be paid by the insurer. If the insurer complies in a timely manner with the recommendation of the neutral evaluator, but the policyholder declines to resolve the matter in accordance with the evaluator's recommendation, the insurer is not liable for extra-contractual (bad faith) damages related to issues determined at the neutral evaluation. The insurer is not liable for attorney's fees, unless the policyholder obtains a more favorable judgment at trial. It allowed residential policies to provide a deductible for sinkhole losses equal to 1 percent, 2 percent, 5 percent, or 10 percent of the dwelling limits.

## **Risk Pooling**

### **Background**

In general, risk pooling available under current law for property insurance is limited to self-insurance funds. Sections 624.460-624.488, F.S. are known as the "Commercial Self-Insurance Fund Act." Self-insurance fund means both commercial insurance funds organized under s. 624.462, F.S., and group self-insurance funds organized under s. 624.4621, F.S. In general, self-insurance is the assumption of some or all of one's financial risk oneself, rather than paying an insurance company to assume it.<sup>13</sup>

### **Commercial Self-Insurance Funds**

Commercial self-insurance funds may be authorized by the OIR to cover property or casualty or surety insurance risks. Such funds may be formed only by:

- 1) a not-for-profit trade association, industry association, or professional association of employers or professionals which has a constitution or bylaws, which is incorporated in Florida, and which has been organized for purposes other than that of obtaining or providing insurance and operated in good faith for a continuous period of 1 year;
- 2) a (medical malpractice) self-insurance trust fund organized pursuant to s. 627.357, F.S., and maintained in good faith for a continuous period of 1 year for purposes other than that of obtaining or providing insurance pursuant to this section;

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<sup>13</sup> <http://www.iii.org/media/glossary/alfa.S/> (last viewed on January 13, 2007).

- 3) a group of 10 or more health care providers for purposes of providing medical malpractice coverage; or
- 4) a not-for-profit group comprised of no less than 10 condominium associations meeting certain requirements.<sup>14</sup>

Requirements for commercial self-insurance funds also include:

- 1) a certificate of authority from the OIR;
- 2) an indemnity agreement binding each fund member to individual, several, and proportionate liability;
- 3) a plan of risk management which has established measures to minimize the frequency and severity of losses;
- 4) proof of competent and trustworthy persons to administer or service the fund;
- 5) an aggregate net worth of all members of at least \$500,000;
- 6) a combined ratio of current assets to current liabilities of more than 1 to 1;
- 7) a deposit of cash or securities, or a surety bond, of \$100,000;
- 8) specific and aggregate excess insurance with limits and retention levels satisfactory to the OIR;
- 9) a fidelity bond or insurance providing coverage of at least 10 percent of the funds handled annually by the fund;
- 10) a plan of operation designed to provide sufficient revenues to pay current and future liabilities, as determined in accordance with sound actuarial principles, and a statement by an actuary to that effect;
- 11) participation in the Florida Self-Insurance Fund Guaranty Association; and
- 12) such additional information as the Financial Services Commission or the OIR reasonably requires.<sup>15</sup>

After the OIR issues a certificate of authority for a commercial self-insurance fund, additional requirements are imposed related to restrictions on premiums that may be written, annual reports, dividends, assessments, and approval of forms and rates.<sup>16</sup> Under current law a commercial self insurance fund is also subject to the premium tax, form and rate approval, and regulatory oversight regarding rehabilitation, liquidation, reorganization and conservation, and is required to participate in the Florida Self-Insurance Guaranty Association.<sup>17</sup>

Rates for commercial self-insurance funds may not be excessive, inadequate, or unfairly discriminatory and must be filed with the OIR for approval.<sup>18</sup>

The Commercial Self-Insurance Fund Act also contains a provision which makes over 228 sections of the Florida Insurance Code applicable to the self-insurance funds.<sup>19</sup> Among those many provisions are laws relating to civil remedy and civil liability; accounting, assets and liabilities investments, administration of deposits, insurance field representatives and operations; unfair methods of competition and unfair or deceptive acts or practices; powers of department and office; cease and desist procedures and penalties; policyholders bill of rights claims administration; payment of settlements; attorney's fees; insurance rates and contracts; motor vehicle and casualty contracts; professional liability claims and actions; reports by insurers and health care providers; and, as previously indicated, provisions relating to insurer insolvency; rehabilitation and liquidation; and the Florida Self-Insurance Fund Guaranty Association.

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<sup>14</sup> s. 624.462(2)(a), F.S. (2006).

<sup>15</sup> s. 624.466, F.S. (2006). Participation in the Florida Self-Insurance Guaranty Association is mandated under s. 624.462, F.S. (2006).

<sup>16</sup> s. 624.468, F.S. (2006); s. 624.470, F.S. (2006) relating to annual reports; s. 624.473, F.S. (2006) relating to dividends; s. 624.474, F.S. (2006) relating to assessments.

<sup>17</sup> s. 624.475, F.S. (2006) relating to premium tax; s. 624.477, F.S. (2006) relating to liquidation, rehabilitation, reorganization, and conservation; s. 624.480, F.S. (2006) relating to approval of forms; s. 624.482, F.S. (2006) relating to rate approval; s. 624.462, F.S. (2006) relating to participation in the Florida Self-Insurance Guaranty Association.

<sup>18</sup> s. 624.482, F.S. (2006).

<sup>19</sup> s. 624.488, F.S. (2006).



Self-insurance is also allowed for workers' compensation insurance through group self-insurance funds. Additionally, pursuant to s. 624.4622, F.S., any two local governments may enter into interlocal agreements to create a self-insurance fund for the purpose of securing the payment of benefits under the workers' compensation law. According to a representative of local government self-insurance funds, these funds are currently also self-insuring for property risks under the home rule powers authorized by the Florida Constitution. Under s. 624.4623, F.S., any two or more independent nonprofit colleges or universities may form a self-insurance fund for the purpose of pooling and spreading liabilities of its group members in any property or casualty risk or surety insurance or securing the payment of benefits under the workers' compensation law.

Both the local government and education self-insurance funds have similar requirements which include:

- having annual premiums in excess of \$5 million;
- maintaining excess insurance coverage and reserve to protect the financial stability of the fund;
- submitting annual audited fiscal year end-financial statements by an independent certified public accountant to the OIR; and
- having a governing body comprised entirely of local elected officials (in local government self-insurance funds) and independent educational institution officials (in educational self-insurance funds).

### **Proposed Changes**

The bill contains several provisions designed to allow more entities to pool their risks or self-insure for property insurance. New entities allowed by the bill to do such are:

- alliances of hospitals;
- non-profit corporations;
- 10 or more associations of condominium associations, cooperative associations, homeowner's associations, vacation and timeshare associations, and mobile home park lot tenant associations; and
- less than 10 community associations if the group formed is non-profit.

The bill allows any hospital alliance, consisting of hospitals of special districts or county or municipality owned hospitals, formed to pool their property risk to borrow, issue, and sell bonds to cover property losses. The bill provides some requirements relating to premium amount, premium calculation, and governing body, but these requirements are not as stringent as those imposed by current law on commercial self-insurance funds. Additionally, the bill provides a hospital alliance is exempt from insurance premium tax.

The bill allows two or more non-profit corporations to form a self-insurance fund for property insurance and sets eligibility and governing requirements for them, such as requirements for premiums, rate setting, and governing body. The eligibility and governing requirements for non-profit corporation self-insurance funds are similar to those of local government self-insurance funds, and independent nonprofit colleges and universities self-insurance funds. The bill provides that the insurance premium tax rate shall be 1.6 percent.

Under current law, a group of condominium associations can form a self-insurance fund for property insurance as long as the group is in existence for at least a year, has more than 10 associations and is initially formed for purposes other than to self-insure. The bill changes current law to expand the type of associations eligible to self insure from condominium associations only to condominium associations, cooperative associations, homeowner's associations, vacation and timeshare associations, and mobile home park lot tenant associations. It removes the eligibility requirement in current law that the association group must have been initially formed for purposes other than insurance and allows the associations to form initially for self-insurance purposes. The bill also removes the requirement that the associations be in existence for one year before they are allowed to self-insure. It also allows community association groups of less than 10 associations to establish a self-insurance fund if the group is non-profit and if the group meets the enumerated requirements to ensure financial solvency.

The bill also clarifies local governments can create a self-insurance fund for property risks as these funds currently self-insure for property risks under the home rule powers authorized by the Florida Constitution. It also allows these entities to issue bonds to cover property losses.

### **Incentive Insurance Capital Build-Up**

#### **Background**

Senate Bill 1980 appropriated \$250 million from General Revenue to the State Board of Administration (SBA) for lending state funds in the form of "surplus notes" to residential property insurers under specified conditions:

- The insurer must contribute new capital to its surplus at least equal to the surplus note and must apply to the SBA by July 1, 2006.
- If the insurer applied after July 1, 2006, but before June 1, 2007, the surplus note was limited to one-half of the new capital contributed by the insurer. No applications were permitted after June 1, 2007.
- The amount of the surplus note could not exceed \$25 million or 20 percent of total funds available for the program (resulting in a \$50 million cap).
- The combination of surplus, new capital, and the surplus note must be at least \$50 million.
- The surplus note must be repayable to the state, with a 20-year term, at the 10-year Treasury Bond interest rate (with interest-only payments for the first 3 years). The Insurance Commissioner must approve the payments on the surplus note, unless he determines the payment would substantially impair the financial condition of the insurer.
- The insurer must meet a minimum writing ratio of net written premiums to surplus of at least 2 to 1 for the term of the surplus note, for residential property insurance in Florida covering the peril of wind. (The SBA has allowed flexibility on this requirement, based on its authority to increase the interest rate on the surplus note if the 2 to 1 ratio is not met.)
- The SBA may approve issuance of a surplus note to an applicant, unless the SBA determines that the financial condition of the insurer and its business plan place an unreasonably high level of financial risk to the state of nonpayment in full of the interest and principal.

As of November 22, 2006, 1,534,576 new property insurance policies from 2006-2009 will be written as a result of the program. The total amount of funds requested from the program is \$244.7 million for 11 insurance companies. The total new capital infused into Florida as a result of the program is \$230 million.

Under the existing program, no preferential treatment is given to insurers who agree to write property insurance for mobile homes, however, these insurers are eligible to participate in the existing program as long as they meet the statutory requirements.

#### **Proposed Changes**

The bill reduces the amount of capital insurers who write only property insurance covering manufactured homes must contribute to participate in the Insurance Capital Build-Up Incentive Program. Insurers writing only property insurance for manufactured homes must contribute \$7 million in capital to receive a matching \$7 million from the state in the form of a surplus note, as opposed to the \$25 million all other insurers participating in the Program must contribute capital. The bill also gives priority for the Program funding distribution to insurers writing only property insurance for manufactured homes if the Program funds are insufficient to allow all applicants to participate.

### **Florida Insurance Guaranty Association**

#### **Background**

Florida operates several insurance guaranty funds to ensure policyholders are protected with respect to insurance premiums paid and settlement of outstanding claims, up to limits provided by law. A guaranty association generally is a not-for-profit corporation created by law directed to protect policyholders from financial losses and delays in claim payment and settlement due to the insolvency of

an insurance carrier. A guaranty association accomplishes its mission by assuming responsibility for settling claims and refunding unearned premiums to policyholders.

In Florida, there are four guaranty associations created in chapter 631, F.S. The Florida Life and Health Insurance Guaranty Association<sup>20</sup> generally is responsible for claims settlement and premium refunds for health and life insurers who are insolvent. The Florida Health Maintenance Organization Consumer Assistance Plan<sup>21</sup> offers assistance to members of an insolvent Health Maintenance Organization (HMO) and the Florida Workers' Compensation Insurance Guaranty Association<sup>22</sup> is directed by law to protect policyholders of workers' compensation insurance. The fourth guaranty association is the Florida Insurance Guaranty Association (FIGA); it is responsible for most remaining lines of insurance, including residential and commercial property, automobile insurance, and liability insurance, among others.

Provisions relating to FIGA, which was created in 1970, are contained in part II of chapter 631, F.S. The law directs FIGA to pay any eligible claim of more than \$100 and less than \$300,000, less any applicable deductible, with a few specified exceptions (s. 631.57, F.S.). Funds available to FIGA are the result of an annual assessment of up to 2 percent of each specified insurer's net direct written premiums for the previous year. The law creates three accounts under FIGA:

- auto liability account;
- auto physical damage account; and
- an account for all other included insurance lines (the all-other account).

Senate Bill 1980, passed in the 2006 Legislative Session, authorized FIGA to impose a 2 percent emergency assessment against its member insurers to fund FIGA obligations resulting from insurer insolvencies created by hurricane claims caused by the 2004 and 2005 hurricanes. In order to impose the emergency assessment, FIGA must certify the need for the assessment to the OIR.

On December 14, 2006, FIGA certified a need for imposition of a 2 percent emergency assessment against member insurers in the "all-other account" doing business in Florida. The assessment was needed to obtain funds to pay covered claims and the reasonable costs of the Association. The OIR issued an Order to all FIGA member insurers on December 15, 2006 requiring the insurers to pay FIGA 2 percent of their Florida net direct written premium for the 2005 calendar year. Payment was due by January 31, 2007.

On January 5, 2007, the Zurich group of insurance companies challenged the OIR December 15, 2006 Order by filing a petition for an administrative hearing<sup>23</sup>. The effect of the challenge is to stay the payment of the 2 percent emergency assessment for the Zurich group pending a decision by an administrative law judge or hearing officer. In its challenge, Zurich alleges FIGA is only statutorily authorized to use the emergency assessment proceeds to retire bonds it issue to pay insolvent insurer's claims. It alleges the assessment cannot be used to directly pay claims.

### **Proposed Changes**

The bill provides clarification to current law that FIGA is authorized to use its emergency assessment directly to pay claims of insolvent insurers, rather than to issue bonds which are in turn utilized to pay such claims.

## **Reinsurance Collateral Requirement**

### **Background**

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<sup>20</sup> Part III of ch. 631 (ss. 631.711-631.737, F.S. (2006)).

<sup>21</sup> Part IV of ch. 631 (ss. 631.811-631.828, F.S. (2006)).

<sup>22</sup> Part V of ch. 631 (ss. 631.901-631.932, F.S. (2006)).

<sup>23</sup> FIGA's certification, OIR's Order and Zurich's Petition are on file with the House Committee on Insurance.

One of the most important duties of an insurance regulator is to regulate the solvency of insurers operating in the state. Current statutory accounting provides insurers with a credit for reinsurance under certain circumstances. The current accounting methodology provides a disincentive for reinsurers domiciled outside the United States (alien reinsurers) to do business in Florida.

Florida law (s. 627.610, F.S.) allows insurers to receive credit on their financial statements for reinsurance ceded to (purchased from) a reinsurer, referred to as the “assuming insurer” only if the assuming insurer is:

- (a) authorized (licensed) in Florida;
- (b) authorized or licensed in another state and has a surplus of at least \$20 million (and meets certain other requirements); or
- (c) an insurer (such as a non-U.S. insurer) that maintains a trust fund in a qualified U.S. financial institution in an amount not less than the insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers (i.e., a 100% “collateral” requirement), plus at least \$20 million (or \$100 million for a group of underwriters, such as Lloyds of London). Such insurers must also submit to U.S. jurisdiction and to certain examination and filing requirements of U.S. regulators.

Testimony at one of the committee meetings of Governor Bush’s Property and Casualty Insurance Reform Committee suggested the collateral requirements currently required of alien reinsurers need to be changed to more fairly reflect the financial ability of the reinsurer.<sup>24</sup> The Office of Insurance Regulation (OIR) has recommended such a change be made giving the Insurance Commissioner the discretion to permit a credit for reinsurance as deemed appropriate. While such a change in the accounting for reinsurance is not likely to have an immediate impact on the capacity of property insurance in the state, it will eliminate any disincentive for alien reinsurers to do business in Florida.

### **Proposed Changes**

The bill gives the Insurance Commissioner discretion whether to allow an insurer who purchases reinsurance from an alien reinsurer to receive credit on their financial statement for reinsurance purchased. However, the bill precludes the Insurance Commissioner from granting credit for the reinsurance unless the alien reinsurer:

- Has over \$100 million in surplus, and
- Has a secure financial strength rating from at least two nationally recognized statistical rating organizations.

If the reinsurer meets the surplus and financial strength criteria, the Insurance Commissioner must determine whether reinsurance credit is given using enumerated statutory factors which serve to ensure the Commissioner considers the regulatory environment and standards where the alien reinsurer is domiciled so that the solvency and financial strength of the alien reinsurer is assured. The Insurance Commissioner is also authorized to lower the trust reinsurance fund requirement for the alien reinsurer in lieu of granting reinsurance credit for an insurer purchasing reinsurance from an alien insurer.

## **Flex Rating**

### **Background**

Senate Bill 1980, passed in the 2006 Legislative Session, allowed an insurer to increase or decrease rates for residential property insurance by up to 5% statewide average, or 10% for any territory, without being subject to a determination by the OIR that the rate is excessive or unfairly discriminatory (except for unfairly discriminatory rating factors prohibited by law) beginning July 1, 2007. This is also called “flex rating”. The flex rating option is only available for residential property insurance in any areas for which the OIR determines that a reasonable degree of competition exists and is only available for use by an insurer once in a 12-month period.

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<sup>24</sup> Testimony received at August 24, 2006 meeting.

## Proposed Changes

The bill suspends the implementation of flex rating for two years by changing the effective date of flex rating from July 1, 2007 to July 1, 2009.

### Citizens Property Insurance Corporation (Citizens)

In 2002, the Florida Legislature created Citizens Property Insurance Corporation (Citizens) which combined the then existing Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA). Citizens is the state's "insurer of last resort" and a property is eligible for coverage with Citizens only if there is no other offer from an authorized insurer.

Citizens offers three types of property and casualty insurance in three separate accounts: 1) Personal Lines Account (PLA) which covers homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies; 2) Commercial Lines Account (CLA) covering condominium associations, apartment buildings and homeowners associations; and 3) High-Risk Account (HRA) which covers personal lines windstorm-only policies, commercial residential wind-only policies and commercial non-residential wind-only policies.

As of October 31, 2006, Citizens provided coverage to almost 1.3 million policyholders, making Citizens the largest insurer in Florida. The number of policyholders in the three accounts are: PLA – 691,972; CLA – 8,029, and HRA – 394,739. Currently, Citizens is averaging 50,000 - 55,000 new applications for coverage per month.

Property is eligible for coverage with Citizens only if there is no other offer from an authorized insurer. The insurance agency and agent must use reasonable efforts to place personal or commercial insurance applicants with an authorized insurer prior to placing the risk with Citizens. Failure to do so is grounds for termination or suspension of the agent appointment.

Beginning March 1, 2007, non-homestead property is eligible in Citizens only if the property owner annually obtains three declinations of coverage from surplus lines insurers and one from an authorized insurer.<sup>25</sup> The definition of homestead property for Citizens' purposes is more expanded than the definition used for property tax purposes.

"Homestead property" is defined as: a) a property granted a homestead tax exemption under ch. 196, F.S., b) property for which the owner has a written lease with a renter for a term of at least 7 months and which is insured by Citizens for \$200,000 or less; c) an owner occupied mobile home permanently affixed to real property, owned by a Florida resident, and either granted a homestead tax exemption or, if the owner does not own the land, for which the owner certifies that the mobile home is his principal place of residence; d) tenants coverage; e) commercial lines residential property; f) any county, district, or municipal hospital; not-for-profit hospital; or continuing care retirement community that is certified under ch. 651, F.S., and receives an ad valorem tax exemption under ch. 196, F.S.<sup>26</sup> All other property is "non-homestead property."<sup>27</sup>

Beginning July 1, 2008, homes insured for \$1 million or more are ineligible for coverage in Citizens.<sup>28</sup> Homes insured for \$1 million or more by Citizens before July 1, 2008 can remain in Citizens for another 3 years if the homeowner annually gets three declinations of coverage from surplus lines insurers and one from an authorized insurer. However, such property can only be covered in the high-risk account and will be considered "non-homestead property." By June 30, 2011, Citizens will not insure any home insured for \$1 million or more.

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<sup>25</sup> s. 627.351(6)(a)6., F.S. (2006).

<sup>26</sup> s. 627.351(6)(a)3., F.S. (2006).

<sup>27</sup> s. 627.351(6)(a)4., F.S. (2006).

<sup>28</sup> s. 627.351(6)(a)5., F.S. (2006).

The bill adds another eligibility requirement for homeowners to obtain property insurance from Citizens. Starting January 1, 2009, all newly constructed buildings within 500 feet landward or seaward of the Coastal Construction Control Line will be ineligible for coverage in Citizens. The Coastal Construction Control Line Program, authorized by the Legislature and administered by the Department of Environmental Protection, prohibits new construction within a certain distance from the water line in order to protect beaches and dunes. Buildings between 500 feet and 2,500 feet from the landward side of the Line must be built to the "code plus" building standard developed by the Florida Building Commission in order to be eligible for property insurance in Citizens. However, if the "code plus" building standard is not developed by January 1, 2009, the buildings must be built to the Miami-Dade Building Code. The bill also precludes the Citizens' eligibility restrictions relating to the Coastal Construction Control Line from applying to residential properties under construction on January 1, 2009 (i.e. for which a building permit has been issued before January 1, 2009).

### **Deficits and Assessments**

If a deficit is incurred in any Citizens' account, the board must levy an immediate assessment on each non-homestead property (as defined in statute) of up to 10 percent of the premium. If this is insufficient to eliminate the deficit, the board must levy an additional assessment against all Citizens' policyholders (including non-homestead policyholders), collected upon renewal, of up to 10 percent of premium. Any remaining deficit is funded by regular and emergency assessments, either recouped from, or directly paid by, non-Citizens' policyholders of property insurance. The regular assessment against insurers could still be imposed as soon as a deficit is determined, but must be reduced by the amounts estimated to be collected from the two 10 percent surcharges.<sup>29</sup>

Lines of business that are subject to Citizens' deficit assessment include insurance for: fire, industrial fire, allied lines, farmowners multiperil, homeowners multiperil, commercial multiperil, and mobile homes, and includes liability coverage on all such insurance except for inland marine and certain vehicle insurance other than the insurance on mobile homes used as permanent dwellings.<sup>30</sup> In other words, all owners of property insurance in Florida are assessed in order to cover the Citizens' deficit, whether or not the property owner is a Citizens' policyholder.

### **Board of Governors**

Citizens operates under the direction of an 8-member Board of Governors. The Governor, Chief Financial Officer, the Senate President, and the Speaker of the House of Representatives each appoint two members of the Board who serve for 3-year terms.<sup>31</sup>

The bill abolishes the current Board on March 1, 2007 and requires the four appointing officers to appoint new Board members or reappoint the current ones by March 2, 2007.

### **Premium Payment Plan**

Prior to the passage of SB 1980 in the 2006 Legislative Session, Citizens was not required by law to offer premium payment plans to its policyholders. However, Citizens had the option to provide payment plans under sections 627.901-627.904, F.S. and 627.826 – 627.849, F.S. which govern payment plans by all insurers. These provisions allow an insurer or an insurance agent to directly provide a premium payment plan or to use a premium financing company to provide a premium payment plan. Starting July 1, 2007, Citizens must offer quarterly and semiannual premium payment plans in accordance with SB 1980.<sup>32</sup>

In addition to the quarterly and semiannual premium payment plans required by current law, the bill requires Citizens to offer monthly premium payment plan. This is consistent with HB1A which changes

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<sup>29</sup> s. 627.351(6)(b)3.i., F.S. (2006).

<sup>30</sup> s. 627.351(6)(b)3.f., F.S. (2006).

<sup>31</sup> s. 627.351(6)(c)4., F.S. (2006).

<sup>32</sup> s. 627.351(6)(c)17., F.S. (2006).

current law to require all property insurers to provide monthly, quarterly, and semiannually premium payment plans.

### **Waiting Period for New Applications**

Beginning July 1, 2007, Citizens requires a 10-day waiting period for new applications.<sup>33</sup> If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application. The Citizens' Board is given discretion whether to approve an exception to the 10-day waiting period for policies needing coverage to be immediately effective for a real estate closing and for other exceptions as the Board determines. The Board has not adopted an exception for real estate closings yet as the 10-day waiting period does not go into effect until July 1, 2007.

The bill removes the Board's discretion whether to approve an exception to the 10-day waiting period for real estate closing by requiring the Board to approve such an exception. The Board, however, maintains its discretion to approve other exceptions to the 10-day waiting period as it deems necessary.

### **Rates**

In order to assure that Citizens rates are not competitive with the voluntary market, the current law requires Citizens rates for its Personal Lines Account be actuarially sound.<sup>34</sup> Additionally, its average rates for each county must be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers (5 insurers for mobile home coverage) with the greatest direct written premium in the state for that line of business. For its High-Risk Account (wind-only policies in coastal areas), the law more generally requires that Citizens rates be actuarially sound and not be competitive with approved rates charged by authorized insurers. However, the law further requires Citizens and the OIR to jointly develop a wind-only ratemaking methodology to meet this purpose, for rates effective on or after July 1, 2004. A wind-only rate methodology was developed that uses a variation of the "Top 20" approach mandated for personal residential multi-peril policies.

The bill requires Citizens' rates to be actuarially adequate and removes the statutory provisions requiring the rates to be non-competitive with the voluntary market. Consequently, Citizens may offer rates that are competitive with private insurance companies.

For Citizens' policies in the Personal Lines Account and the Commercial Lines Account issued or renewed on or after March 1, 2007, a rate is deemed inadequate if the rate, including investment income, is not sufficient to provide for the purchase of reinsurance coverage from the Florida Hurricane Catastrophe Fund and private reinsurance (whether or not purchased) and to pay all claims and expenses reasonably expected to result from a 100-year probable maximum loss event (i.e., a 1-in-100 year hurricane), without resort to assessments or other outside funding sources.<sup>35</sup> As of June 30, 2006, Citizens' 100 year PML for its Personal Lines Account is \$5.891 billion. To implement the 100-year PML requirement, Citizens anticipates a 3.4% rate increase for the policies in its Personal Lines Account effective March 1, 2007.

For Citizens' policies in the High-Risk Account (wind-only coverage in coastal areas) issued or renewed on or after March 1, 2007, a rate is deemed inadequate if the rate, including investment income, is not sufficient to provide for the purchase of reinsurance coverage from the Florida Hurricane Catastrophe Fund and private reinsurance (whether or not purchased) and to pay all claims and expenses reasonably expected to result from a 70-year probable maximum loss event, without resort to assessments or other outside funding sources. For policies in the High-Risk Account issued or renewed in 2008 and 2009, the rate must be based upon an 85-year and 100-year probable maximum loss event, respectively.<sup>36</sup> As of June 30, 2006, Citizens' 100 year PML for its High-Risk Account is

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<sup>33</sup> s. 627.351(6)(c)6., F.S. (2006).

<sup>34</sup> s. 627.351(6)(m), F.S. (2006) addresses how Citizens' rates are set.

<sup>35</sup> s. 627.351(6)1.a., F.S. (2006).

<sup>36</sup> s. 627.351(6)1.a., F.S. (2006).

\$12.187 billion. To implement the 70-year PML requirement, Citizens anticipates a 53.1% rate increase for the policies in its High-Risk Account effective March 1, 2007.

The bill removes the statutory requirement that Citizens include the cost of private reinsurance in its rates whether or not it purchases private reinsurance. It also changes the PML requirement for high risk account rates from a 70-year PML to a 50-year PML with a transition period to a 100-year PML over a five year period beginning 2009 when the PML requirement increases in 10-year increments each year. This will reduce the anticipated 53.1% rate increase scheduled to go into effect on March 1, 2007 to 19.9% for the HRA.

The bill rescinds the Citizens' rate filing that went into effect on January 1, 2007 except for the rate filing for Monroe County which reduced rates. This rate filing was to make Citizens' rates actuarially sound and was the first time Citizens made a rate filing on an actuarially sound basis. The rate filing resulted in a statewide average rate increase as follows:

HRA Homeowners:	16.7% increase
HRA Mobile homeowners:	13.1% increase
PLA Homeowners:	12.0% increase
PLA Mobile homeowners:	0% increase
Commercial Residential Homeowners:	0% increase

For those policyholders that have already paid premiums based on the January 1, 2007 rate, the bill requires Citizens to refund the premiums paid.

For one year (2007), the bill freezes Citizens' rates to those that were in effect on December 31, 2006. This will result in immediate premium reductions for Citizens' policyholders. During the 1 year rate freeze, Citizens is still able to make rate filings which will reduce rates further during the year; they are just not allowed to increase rates. Citizens is required to make a rate filing demonstrating what rate increases or decreases are needed to make its rates actuarially adequate starting January 1, 2008.

### **Task Force on Citizens Property Insurance Claims Handling and Resolution**

The bill creates the Task Force on Citizens Property Insurance Claims Handling and Resolution. The Task Force is in existence until the end of the 2006-2008 legislative biennium and is directed to study issues relating to how Citizens currently handles, adjusts, and disposes of its claims in order to recommend improvement in such. The Task Force is required to report two times to the Legislature, the Governor, and the Chief Financial Officer on its findings. The first report, due July 1, 2007, must provide findings and recommendations about how Citizens' can dispose of still-open claims from the 2004 and 2005 hurricane season. The second report, due July 1, 2008, must provide findings and recommendations about how Citizens can more efficiently and timely handle, adjust, and dispose of future claims.

### **Report on Citizens' Agent Commissions**

Agents collect a commission for the sale of insurance and continued support associated with the insurance. Agent commissions are generally paid as a percentage of premium. The current commission levels filed by Citizens are: 10 percent for PLA (multi-peril residential), 10 percent for HRA residential (wind-only residential), 12 percent for CLA (multi-peril commercial residential), and 12 percent for HRA commercial residential and HRA commercial (wind-only commercial residential and commercial).

The bill directs the Department of Financial Services (DFS) to review how Citizens' agent commissions are set and to make recommendations to the Legislature and Governor by July 1, 2007 regarding standards to justify agent commissions. Similarly, HB1A requires DFS to review agent commissions paid by all insurers and to make recommendations regarding standards for agent commissions.

## **Property Insurance For Commercial Property**



## **Background**

Many of the challenges faced by the residential property market are mirrored in the commercial non-residential (business) property market. The heightened expectation of future losses, both in terms of frequency and severity of storms, coupled with the increased cost of reinsurance have been significant detriments to the commercial property market.

Beginning in May and June of 2006, business policyholders experienced an increase in nonrenewals or cancellations of policies, significant rate increases, increases in deductibles, and/or less coverage with higher rates for property insurance coverage. The Department of Financial Services, members of the Cabinet, and the Office of Insurance Regulation (OIR) began to receive complaints from businesses, particularly small businesses, that their property insurance was being non-renewed or the price was increasing to the point that the business could not continue. In response to concerns, the OIR conducted a Commercial Business Property Insurance Survey for a two-week period starting July 12, 2006. The survey was available to businesses wishing to participate and was accessible via the Internet. The intent of conducting this survey was to evaluate the commercial business property insurance market to address the challenges currently faced by business owners in the state.

The OIR survey was sent to chambers of commerce and other organizations to gather unscientific confirmation of the capacity shortage. The OIR survey received 1,914 responses from Florida businesses. Approximately 80 percent of the survey respondents reported an increase in property insurance deductibles; found coverage which seemed unreasonable; found coverage but not all that was desired; or did not find coverage. Ninety-six percent of the respondents had rate increases and 38.2 percent reported an increase of over 100 percent in the price of property coverage. Sixty-nine percent were located within 10 miles of the coast.

The results of the survey, coupled with the results of business inquiries made to the Florida Market Assistance Plan (FMAP) prompted Insurance Commissioner McCarty to consider alternative means of providing commercial property coverage to Florida businesses. Most of the options for providing more capacity required legislative changes, however, re-activation of the Property and Casualty Joint Underwriting Association (PCJUA) was a viable option because it could be done by the Financial Services Commission (FSC), by administrative rule, and without a legislative change.

## **Property and Casualty Joint Underwriting Association (PCJUA)**

The PCJUA was created in 1986 by section 627.351(5), Florida Statutes, to deal with a commercial insurance crisis at that time. It was eventually deactivated, but the enabling statute remained along with the triggering mechanism which allows for reactivation. According to statute, the PCJUA is overseen by a 13-member board that is appointed by the Chief Financial Officer and financed by premiums along with potential assessments and post-catastrophe bonding.

On August 15, 2006, the FSC approved an emergency rule establishing the activation of the PCJUA to make commercial property insurance available to Florida businesses unable to find coverage in either the admitted or surplus lines insurance markets.

Under current law, for the PCJUA to be activated, a minimum of 100 applications had to be received by the Florida Market Assistance Plan (FMAP) within a 3-month period. FMAP was required to try to find coverage and unless 80 percent of those applicants received a quote for insurance coverage, the statutory trigger was met. FMAP reported that it received the 100 applications, shopped for coverage and only 11 percent of the applicants received tentative quotes for coverage. Therefore, the trigger requirement was met for commercial property insurance.

The organizational meeting of the PCJUA's new board of directors was held on August 25, 2006. The Board approved a contract with a service provider ICAT, with the PCJUA accepting applications and writing its first policy in September. The PCJUA was fully operational in October 2006.

The PCJUA currently writes wind-only coverage for commercial non-residential properties throughout the state except those areas in which Citizens writes wind-only policies (within the windstorm boundaries). Due to the limited assessment base<sup>37</sup> currently in statute (the commercial non-residential property market), the Board voted to write coverage only for properties valued at \$1 million or less. Any deficits are assessed against commercial property insurers, limited to 10% of net written premium.

The PCJUA also provides contents coverage for up to \$750,000 and business interruption coverage up to \$250,000 for a total amount of coverage of \$2 million. In order to qualify for coverage with the PCJUA, coverage must be unavailable in the private market, including the surplus lines market. As of October 26, 2006, the PCJUA has:

- made 1,595 quotes for coverage;
- bound 108 policies with 166 total buildings;
- written \$772,000 in premium for a total insured value of \$43.9 million;
- appointed 446 agents;

Other statistics regarding the PCJUA are as follows:

- premium for 76 percent of policies was less than \$10,000;
- 74 percent of quotes were for buildings constructed prior to 1990;
- 80 percent of quotes were for properties five miles or less from the coast; and
- the three leading counties by total insured value were Brevard, Escambia and Hillsborough.

### **Commercial Property Insurance Written by Citizens Property Insurance Corporation**

The only commercial, non-residential, coverage provided by Citizens is wind-only coverage for commercial properties located in the designated “high-risk” territories/windpool territory. Coverage is limited to \$1 million (i.e., a building valued over \$1 million is eligible for coverage up to \$1 million). Properties valued over \$1 million must get coverage for losses greater than \$1 million up to the insured value of the property from the admitted or surplus lines market. Citizens currently has approximately 45,000 policies covering windstorm for commercial properties located in the windpool territory.

### **Proposed Changes**

Beginning June 1, 2007, the bill transfers all commercial non-residential policies out of Citizens and into the PCJUA. The PCJUA is directed to provide coverage for commercial non-residential policies located anywhere in the state and is directed to write coverage for the first \$1 million of total insured value. This is an expansion of the coverage for the PCJUA both in terms of location of the property covered and in terms of the dollar value of property covered. The anticipated effect of this change is to increase the number of policies in the PCJUA because of the transfer of the 45,000 Citizens’ policies to it and because of the expansion in coverage.

The bill adds another eligibility requirement for homeowners to obtain property insurance from the PCJUA. Starting January 1, 2009, all newly constructed buildings within 500 feet landward or seaward of the Coastal Construction Control Line will be ineligible for coverage in the PCJUA. The Coastal Construction Control Line Program, authorized by the Legislature and administered by the Department of Environmental Protection, prohibit new construction thin a certain distance from the water line in order to protect beaches and dunes. Buildings between 500 feet and 2,500 feet from the landward side of the Line must be built to the “code plus” building standard developed by the Florida Building Commission. However, if the “code plus” building standard is not developed by January 1, 2009, the buildings must be built to the Miami-Dade Building Code. The bill also precludes the PCJUA’s eligibility restrictions relating to the Coastal Construction Control Line from applying to commercial properties

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<sup>37</sup> The assessment base is about \$1.3 billion, which limits annual assessments to \$130 million. (In comparison, each account of Citizens has an assessment base of about \$8 billion.)

under construction on January 1, 2009 (i.e. for which a building permit has been issued before January 1, 2009).

## Sinkholes

### **Background**

A sinkhole is defined in Florida law as a landform created by subsidence of soil, sediment, or rock as underlying strata are dissolved by groundwater.<sup>38</sup> A sinkhole may form either by the ground collapsing on itself to form a hole or by the ground settling to form a crater or indentation in the soil. Since 1981, in Florida, insurers offering property coverage to homeowners have been required by law to provide coverage for damage resulting from sinkholes, both to covered structures and for stabilizing the ground beneath covered structures.<sup>39</sup>

### **Increase in Sinkhole Appearance in Florida**

Sinkhole formation is aggravated and accelerated by urbanization. Development increases water usage, alters drainage pathways, adds weight to the ground surface, and redistributes soil. According to the Federal Emergency Management Agency (FEMA), the number of human-induced sinkholes has doubled since 1930. Similarly, insurance claims from Florida homeowners for damages resulting from sinkholes have increased dramatically both in number and costs over the past 20 years.<sup>40</sup>

Although a sinkhole can form without warning, specific signs can signal potential development. Some potential indications of the presence of a sinkhole include:

- Slumping or falling fence posts, trees, or foundations;
- Sudden formation of small ponds or loss of water from same;
- Sudden appearance of a crater or hole;
- Wilting vegetation;
- Discolored well water; and
- Structural cracks in ceiling, walls, and floors.<sup>41</sup>

### **Current Law and Changes Proposed by the Bill**

Several sections of current law govern the requirements for property insurance policies regarding coverage for sinkholes.<sup>42</sup> Under current law, every insurer authorized to offer residential or commercial property insurance must make sinkhole coverage available to policyholders.<sup>43</sup>

Insurers are not allowed to nonrenew property insurance policies on the basis that a sinkhole claim was filed by the policyholder as long as the claim payment is less than policy limits and the policyholder has repaired the structure.<sup>44</sup>

Section 627.706, F.S., allows residential property insurers to include in homeowners' policies specific deductibles applicable only to coverage for sinkhole losses. In other words, a homeowner can have a sinkhole deductible that is in addition to their hurricane deductible and to their fire, theft, and liability deductible. An insurer is authorized to offer a deductible for sinkhole losses of 1 percent, 2 percent, 5 percent, and 10 percent of the policy dwelling limits. An insurer also must offer a premium discount for each deductible amount applicable to sinkhole losses.

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<sup>38</sup> s. 627.706, F.S. (2006).

<sup>39</sup> Section 2, chapter 81-280, Laws of Florida (LOF).

<sup>40</sup> University of Florida; Institute of Food and Agricultural Sciences (IFAS); *Plant Management in Florida's Waters: Sinkholes*; available at <http://aquat1.ifas.ufl.edu/guide/sinkholes.html>, (viewed January 14, 2007).

<sup>41</sup> *Id.*

<sup>42</sup> See sections 627.706, 627.7061, 627.7065, 627.707, 627.7072, 627.7073, 627.7074, and 627.7077, F.S., (2006).

<sup>43</sup> s. 627.706(1), F.S. (2006).

<sup>44</sup> s. 627.707(8), F.S. (2006).

The bill defines “catastrophic ground cover collapse” and uses this term in the statutory definition of “loss.” The bill then deletes current law requiring insurers to make coverage for “sinkhole losses” available to policyholders and replaces it with a requirement that insurers make coverage available for losses resulting from a “catastrophic ground cover collapse.” Catastrophic ground cover collapse is defined as ground cover collapse that occurs within 7 days and that which makes a home inhabitable. Other conforming definitional changes are also provided.

C. SECTION DIRECTORY:

**Section 1.** Provides a short title.

**Section 2.** Amends s. 163.01, F.S., relating to Florida Interlocal Cooperation Act of 1969.

**Section 3.** Amends s. 215.5595, F.S., relating to Insurance Capital Build-Up Incentive Program.

**Section 4.** Amends s. 624.462(2)(a), F.S., relating to commercial self-insurance funds.

**Section 5.** Amends s. 624.4622(1), F.S., relating to local government self-insurance funds.

**Section 6.** Creates s. 395.106, F.S., relating to risk pooling by certain hospitals and hospital systems.

**Section 7.** Creates s. 624.4625, F.S., relating to corporation not for profit self-insurance funds.

**Section 8.** Amends s. 624.610(3), F.S., relating to reinsurance.

**Section 9.** Amends s. 627.062(2)(j), F.S., relating to rate standards.

**Section 10,** Amends s. 627.351, F.S., relating to insurance risk apportionment plans.

**Section 11.** Creates an unnumbered statute; requires DFS to review agent commissions for Citizens’ policies and renewals, requires a report by July 1, 2007.

**Section 12.** Creates an unnumbered statute; creates a task force to study Citizens’ claims handling and resolution, requires reports by July 1, 2007 and July 1, 2008.

**Section 13.** Creates an unnumbered statute; removes the current board of governors for Citizens and requires appointment of new members within a specified time.

**Section 14.** Amends s. 631.57, F.S., relating to powers and duties of the association.

**Section 15.** Creates an unnumbered section, clarifies intent of s. 34, chapter 2006-12, L.O.F.

**Section 16.** Amends s. 627.706, F.S., relating to sinkhole insurance; definitions.

**Section 17.** Provides an effective date on becoming law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Expand the Types of Entities That Can Form a Commercial Self -insurance Fund

The Revenue Estimating Conference has not yet reviewed this issue for impacts to insurance premium tax revenues. However, the impact appears to be negative and indeterminate.

### Hospital Alliance Insurance Premium Tax Exemption

The Revenue Estimating Conference has not yet reviewed this issue for impacts to insurance premium tax revenues. However, the impact appears to be negative and indeterminate.

### Allow Not for Profits to Form Self-insurance Funds

The Revenue Estimating Conference reviewed a similar measure on April 5, 2006 and estimated a positive indeterminate fiscal impact on insurance premium tax revenues.

## 2. Expenditures:

### Review of Insurance Agent Commissions

There will be no fiscal impact upon the Office of Insurance Regulation.

### Task Force on Citizens Property Insurance Claims Handling and Resolution

There will be an insignificant cost for the task force that the Office of Insurance Regulation can absorb within its existing resources.

The Department of Financial Services estimates that it will incur expenditures of \$50,000 in administering the Task Force on Citizens Property Insurance Claims Handling and Resolution.

## B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

### 1. Revenues:

None.

### 2. Expenditures:

None.

## C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Inasmuch as the bill allows corporations not for profit, various types of community associations, and specified hospitals to self-insure or pool risk in lieu of obtaining insurance from a private insurance carrier, these entities may save money on insurance premiums.<sup>45</sup> The amount of premium dollars saved for each entity is indeterminable. Additionally, if premiums collected by the risk pool or self-insurance fund are not sufficient to pay claims and a deficit results, the pool or fund's members must be assessed to cover the deficit.

Reducing the amount of capital insurers who write only property insurance covering mobile homes need to contribute to participate in the Incentive Insurance Capital Build Up Program may result in lower property premiums for mobile homeowners if insurers participate in the Program. Participation in the Program will bring more capacity into the mobile homeowners property insurance market which should in turn move some mobile homeowners out of Citizens and into the admitted market. Because Citizens is required by law to charge the highest rate, the admitted market rates should be lower. However, because current Program funds are completely distributed, unless additional monies are

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<sup>45</sup> The portion of the premium rate attributable to cover claims should be approximately the same as the portion charged by private insurers; however, premium rates for self-insurance funds typically do not include a profit factor (usually about 5 percent of premium). Additionally, self-insurance funds sometimes have less expense than private insurers. The absence of a profit factor built into premium rates and lower expenses could lead to premium rates for self-insurance funds that are lower than those of private insurers.

appropriated no insurers writing only mobile homeowners property insurance will be able to participate in the Program.

Relaxing the collateral requirements for alien reinsurers may encourage more alien reinsurers to offer reinsurance for Florida properties which in turn increases capacity which may lower rates or depopulate Citizens.

Precluding coverage in Citizens and the PCJUA for new construction built within a specified distance from the Coastal Construction Control Line will likely cause increased property insurance premiums for these property owners as they will likely have to obtain property insurance in the surplus lines market rather than the admitted market. The surplus lines market has no rate regulation by the OIR. Any rate increase associated with this change will not occur until 2009 when the provision goes into effect.

Requiring property owners of new construction built within a specified distance from the Coastal Construction Control Line to build to "code plus" will likely increase construction costs for the property as "code plus" is defined to be building standards in excess of the Florida Building Code. This increase is only applicable to property owners in Citizens and the PCJUA.

Requiring Citizens' rates to be actuarially adequate starting in 2008 is likely to increase rates for Citizens' policyholders in 2008. Citizens' first actuarial rate filing which was to become effective on January 1, 2007 was approved for rate increases for HRA homeowners (16.7%), HRA mobile homeowners (13.1%), and PLA homeowners (12%), however, these rate increases are rescinded in the bill.

Requiring Citizens to be competitive with the voluntary market may lower rates for some Citizens' policyholders, but maintaining the requirement that Citizens' rates be actuarially adequate will likely cause Citizens' rates to be higher than the admitted market. This will be effective starting in 2008 after the Citizens' rate freeze expires.

Removing the inclusion of the cost of private reinsurance in Citizens' rates should lower their rates, however, maintaining the requirement that Citizens' have sufficient funds to cover a specified PML event may cause Citizens' rates to increase. Requiring a 50-year PML for the HRA will increase current Citizens' rates by 19.9% and the PLA rates by 3.3%. However, if Citizens does not have to use its premiums to pay claims in a year and can carry them over to the next year, the rate increase needed for Citizens to accumulate sufficient cash to fund a specified PML event will be decreased. Any rate increase associated with the PML requirement will not occur until 2008 after the Citizens' rate freeze expires.

Rescinding Citizens' rate filing that was effective January 1, 2007 and freezing Citizens' rates for 2007 will reduce Citizens' rates by 16.7% for HRA homeowners, 13.1% for HRA mobile homeowners, and 12% for PLA homeowners. However, the bill does not rescind rate filings made by property insurers in the private admitted market. Thus, rates for the over 3 million policyholders not in Citizens but in the private market will continue to increase or decrease throughout 2007 as the rate filings are made and approved by the OIR.

Transferring all commercial non-residential property from Citizens to the PCJUA will immediately increase the number of policies in the PCJUA. This increases the likelihood the PCJUA will not have sufficient funds to pay claims and thus have to assess all commercial non-residential insurers. Any assessment will be passed on by insurers to policyholders and are statutorily capped at 10% a year.

#### D. FISCAL COMMENTS:

None.

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

The mandates provision does not apply because this bill does not: require counties or municipalities to spend funds or to take an action requiring the expenditure of funds; reduce the authority that municipalities or counties have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

##### 2. Other:

None.

#### B. RULE-MAKING AUTHORITY:

None given in bill.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

On January 16, 2007 the Jobs & Entrepreneurship Council heard the bill, adopted 5 amendments and reported the bill favorably with a Proposed Council Substitute. The amendments made the following changes to the original bill:

- Allows community association groups of less than 10 associations to establish a self-insurance fund if financial solvency is guaranteed and certain notification requirements are met.
- Clarifies the PCJUA eligibility restriction associated with the Coastal Construction Control Line does not apply to properties permitted before January 1, 2009.
- Clarifies the Citizens Property Insurance Corporation eligibility restriction associated with the Coastal Construction Control Line does not apply to properties permitted before January 1, 2009.
- Amends hospital risk pooling language to allow all hospitals to participate in risk pooling. (i.e. deletes requirement that hospitals be county, teaching, or children's and a non-profit one to participate in hospital risk pooling)
- Transfers the statutory language allowing hospitals to participate in a risk pool and setting forth the guidelines and restrictions for such from the Insurance Code to Chapter 395 which governs hospital licensing and regulation.

The staff analysis was updated to reflect adoption of the amendments.