

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 Community Affairs Committee

BILL: CS/SB 742

INTRODUCER: Banking and Insurance Committee and Senator Fasano

SUBJECT: Property Insurance Sinkhole Losses

DATE: March 6, 2009

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	Fav/CS
2.	Murphy	Yeatman	CA	Favorable
3.			GA	
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

- | | | |
|------------------------------|--|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="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:

Senate Bill 742 mandates the creation of a building code effectiveness grading schedule that evaluates the effectiveness of sinkhole loss prevention ordinances in reducing the number of sinkholes and the severity of sinkhole losses. The bill further mandates the creation of insurance premium discounts or surcharges on personal residential property insurance based on a property's compliance with sinkhole loss prevention ordinances and the effectiveness of the ordinance as determined by the grading schedule. The grading schedule will:

- Be adopted by the Financial Services Commission by rule;
- Be based on the effectiveness of code enforcement in each county and scientific, modeling, and engineering methodologies; and
- Evaluate ordinances no earlier than 4 years after the ordinance takes effect.

This bill creates section 627.7063, Florida Statutes.

II. Present Situation:

Catastrophic Ground Cover Collapse Coverage

Section 627.706(2)(a), F.S., provides that every authorized insurer must provide coverage for “catastrophic ground cover collapse,” defined as geological activity that:

- Results in the abrupt collapse of the ground cover that is clearly visible to the naked eye;
- Results in structural damage to the building and its foundation; and
- Results in the insured structure being condemned and ordered to be vacated by the appropriate governmental agency.

Catastrophic ground cover collapse coverage does not provide reimbursement for losses due to the mere settling or cracking of a foundation, structure or building. In addition to providing catastrophic ground cover collapse coverage, each insurer must make available sinkhole insurance coverage for an appropriate additional premium. The coverage was created in Special Session 2007-A as an alternative to sinkhole insurance, which had become increasingly costly in areas of the state with high exposure to sinkholes and related claims.

Sinkhole Insurance Coverage

Florida law defines a sinkhole¹ as a landform created by subsidence of soil, sediment, or rock as underlying strata are dissolved by groundwater. In 2006 and 2007, the Legislature enacted multiple changes to the laws governing sinkhole insurance coverage. Until 2007, each authorized insurer was required to make available coverage for insurable sinkhole losses on any structure and the personal property contained within it. Though insurers were not required to include the coverage in all policies, most did so to avoid adverse selection, i.e. only providing coverage to sinkhole prone areas. In 2007, the Legislature mandated the inclusion of “catastrophic ground cover collapse” coverage while requiring that insurers continue to offer sinkhole coverage for an appropriate additional premium.

In some areas of the state (generally Florida’s gulf coast and adjacent counties), sinkhole claims and associated costs began growing at an exponential rate. This caused policy cancellations due to the payment of policy limits on sinkhole claims, and insurers refused to issue new policies in sinkhole prone areas. Citizens Property Insurance Corporation had a significant increase in policies from the Tampa Bay area (Hernando, Hillsborough, Pasco, and Pinellas counties), due to private insurance companies refusing or limiting coverage in this area due to the sinkhole exposure. Not only did more homeowners have to seek coverage from Citizens, but such policyholders were required to pay sharply increasing premium costs with the average premium from Citizens in Hernando, Hillsborough, Pasco, and Pinellas counties doubling from 2003 to 2006.

In response, the 2006 Legislature made a number of changes to the sinkhole law, including allowing deductibles of up to 10 percent for sinkhole coverage, and making it unlawful for a contractor or business providing sinkhole remediation services to communicate with any attorney for the purpose of soliciting legal business. A neutral evaluation process for the expert evaluation of sinkhole claims disputes was also created. A neutral evaluation conducted by a DFS certified

¹ Section 627.706(2)(b), F.S.

engineer or geologist is mandatory but non-binding when requested by either party, with costs of the evaluation to be paid by the insurer. If the insurer timely complies with the recommendation of the neutral evaluator, but the policyholder declines to resolve the matter pursuant to the evaluator's recommendation, the insurer is not liable for extra-contractual (bad faith) damages related to issues determined at the neutral evaluation. In addition, the insurer is not liable for attorney's fees, unless the policyholder obtains a judgment at trial that is more favorable than the recommendations of the neutral evaluator.

Sinkhole Preventive Local Ordinances

Pasco County has promulgated two local ordinances designed to reduce sinkhole risk. The ordinances create additional requirements regarding investigating and repairing sinkhole threatened property. The Pasco County ordinances:

- Require the filing of permits for investigating and repairing ground settlement (thus creating a way to identify properties that may be at risk from geologic hazards);
- Require investigation and testing for geologic hazards via a Geotechnical/Geological engineering report pursuant to submitting a development plan for approval;
- Require corrective action if slumping or sinkhole formation becomes evident; and
- Prohibit construction in areas where geologic hazards exist and are not remediated.
 - The county currently has a proposed amendment to increase foundation standards to include additional rebar to strengthen the ability of a foundation to withstand settlement activity.

Discounts and Credits Applied to Property and Casualty Insurance

Florida law currently does not require property insurers to provide discounts to consumers who own structures inspected or built to withstand sinkhole loss in accordance with local ordinances and amendments to the Florida Building Code. Florida currently requires property insurers to provide rate discounts and credits for windstorm mitigation and proper enforcement of the Florida Building Code.

Florida requires property insurers to provide actuarially reasonable discounts, credits, rate differentials, or reductions in deductibles to residential property insureds that install or implement windstorm damage mitigation techniques. Section 627.0629, F.S., contains the statutory requirements placed on insurers when providing discounts for wind mitigation. Wind discounts in Florida are based on loss relativities studies conducted by Applied Research Associates in 2002.²

The Insurance Services Office conducts the Building Code Effectiveness Grading Schedule (BCEGS), which assesses building codes in effect in a particular community and the effectiveness of code enforcement. The BCEGS rates communities and counties from a scale of 1 (high) to 10 (low), with discounts available for communities with high ratings and surcharges applied to communities with low ratings. In Florida, BCEGS considers the degree to which communities and counties comply with the Florida Building Code. The schedule does not provide additional discounts for local and county ordinances that impose requirements more

² The reports are entitled *Development of Loss Relativities for Wind Resistive Features of Residential Structures* and *Development of Loss Relativities for Wind Resistive Features for Residential Buildings with Five or More Units*.

stringent than those contained in the Florida Building Code. As such, BCEGS does not include within its evaluations ordinances that provide enhanced protection against sinkholes and similar geologic conditions. A representative with the Insurance Services Office indicated to professional staff that BCEGS does not currently contemplate sinkholes.

III. Effect of Proposed Changes:

Section 1. Creates s. 627.7063, F.S.; mandating the creation of a building code effectiveness grading schedule that evaluates the effectiveness of sinkhole loss prevention ordinances in reducing the number of sinkholes and the severity of sinkhole losses. The grading schedule will:

- Be adopted by the Financial Services Commission by rule. (The Financial Services Commission is likely to rely on personnel of the Office of Insurance Regulation to develop the rule; the OIR does not have rulemaking authority itself.);
- Be based on the effectiveness of code enforcement in each county and scientific, modeling, and engineering methodologies; and
- Evaluate ordinances no earlier than 4 years after the ordinance takes effect. (The four year time period is designed to allow for the gathering of data regarding the frequency and severity of sinkhole damage to structures that are required to be compliant with the sinkhole prevention ordinance in question.)

The commission must also adopt rules mandating insurance premium discounts or surcharges on personal residential property insurance based on a property's compliance with an ordinance and the grade assigned to the applicable sinkhole loss prevention ordinance.

Section 2. The act takes effect January 1, 2010.

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 intent of the legislation is to require insurers to consider local ordinances and amendments to the Florida Building Code that have the effect of reducing sinkhole loss, thus reducing the rates that consumers pay for sinkhole coverage in those areas. Proponents of the legislation believe that local ordinances will reduce the number and severity of sinkhole claims and render compliant properties far less likely to suffer sinkhole loss. The bill will help make sinkhole coverage affordable for consumers living in property that, due to such ordinances, does not face exposure to the large degree of sinkhole risk that led to the large increases in sinkhole premiums over the past decade.

Representatives of property and casualty insurers have expressed concern that the discounts required by the bill for sinkhole preventive ordinances may not accurately reflect the benefits of such measures. Insurers assert that wind mitigation discounts have been developed through on-field testing, computer modeling, and scientific study; while local ordinances to prevent sinkholes lack a similar treatment to this point. The OIR notes that ordinances and amendments to the Florida Building Code that lessen the insurer's actual claims experience will reduce rate indications over time that reflect the insurer's improved loss experience. A representative with the Insurance Services Office indicated that they could modify the BCEGS program to evaluate sinkhole exposure, but there is currently little science, modeling, or engineering that evaluates the effectiveness of sinkhole preventive measures.

C. Government Sector Impact:

The building code effectiveness grading schedule is required to be based on scientific, modeling, and engineering methodologies. The OIR may need to procure such methodologies via contract with an outside party due to the current paucity of objective, scientific testing of the effectiveness of sinkhole preventive ordinances. However, the office may not need to contract out for such services during the 2009-2010 fiscal year given the bill's effective date of January 1, 2010, and the requirement that the grading schedule not be used to evaluate an ordinance until at least 4 years after it is enacted.

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.)

The Committee Substitute mandates the creation of a building code effectiveness grading schedule that evaluates the effectiveness of sinkhole loss prevention ordinances in reducing the

number of sinkholes and the severity of sinkhole losses. The grading schedule will be based on the effectiveness of code enforcement in each county and scientific, modeling, and engineering methodologies; and evaluate ordinances no earlier than 4 years after the ordinance takes effect. The original bill required insurers to “consider” such ordinances when assessing risks and setting rates.

B. Amendments:

None.