

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1327 Limited Sinkhole Coverage Insurance

SPONSOR(S): Insurance & Banking Subcommittee; Ingoglia

TIED BILLS: **IDEN./SIM. BILLS:** SB 1274

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 0 N, As CS	Lloyd	Luczynski
2) Government Operations Appropriations Subcommittee	11 Y, 0 N	Keith	Topp
3) Regulatory Affairs Committee			

SUMMARY ANALYSIS

A sinkhole is defined in law as a landform created by subsidence of soil, sediment, or rock as underlying strata are dissolved by groundwater. Catastrophic ground cover collapse is also defined in the law and is more severe than sinkhole loss. Florida law requires property insurers to cover only catastrophic ground cover collapse, rather than all sinkhole loss, in the base property insurance policy. But, insurers must also offer policyholders sinkhole loss coverage, for an appropriate additional premium.

Currently to recover under a sinkhole insurance policy a homeowner must have experienced sinkhole loss. Sinkhole loss means structural damage to the covered building, including the foundation, caused by sinkhole activity. Contents coverage and additional living expenses apply only if there is structural damage to the covered building caused by sinkhole activity.

In 2011, the Legislature reviewed the sinkhole law and enacted comprehensive reforms addressing all areas of the law, including defining structural damage. The reforms were in response to the increasing number and cost of sinkhole claims. The goal of the reforms was to keep sinkhole loss insurance available to homeowners while providing more certainty in sinkhole claims for homeowners and insurers in terms of coverage, costs, repairs, and exposure.

The bill creates a new type of sinkhole coverage. Among its key features, the bill:

- Permits an authorized insurer to issue a "limited sinkhole coverage insurance" policy providing personal lines residential coverage for the peril of sinkhole loss on any structure or the contents of personal property;
- Covers only losses from the perils of sinkhole loss as the term "sinkhole loss" is currently defined in law;
- Coverage of loss of personal property or contents is not required; coverage may be limited to stabilization of the building and repair of the foundation; coverage of land stabilization is not required;
- Allows policy limits, subject to a minimum limit, and deductibles as agreed by the insurer and insured;
- Requires the insured's signed acknowledgement of reading and understanding the policy limitations, including a notice, with prescribed text;
- Does not apply to commercial lines residential coverage, commercial lines nonresidential coverage, or excess coverage for the peril of sinkholes;
- Does not require form filing;
- Establishes surplus requirements;
- Removes certain limitations on the exportation of policies to the surplus lines until July 1, 2020;
- Until October 1, 2019, these limited sinkhole coverage insurers will not be subject to file and use rate review by the Office of Insurance Regulation; and
- Prohibits assignment of a post-loss claim, except to a subsequent property purchaser.

The bill has no fiscal impact on state or local government. The bill has an indeterminate fiscal impact on the private sector.

The bill is effective on July 1, 2016.

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

STORAGE NAME: h1327c.GOAS

DATE: 2/16/2016

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

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.¹ Sinkholes occur in certain parts of Florida due to the unique geological structure of the land. Sinkholes are geographic features formed by movement of rock or sediment into voids created by the dissolution of water-soluble rock. This type of subsidence formation may be aggravated and accelerated by urbanization, suburbanization, water usage, and changes in weather patterns.

Since 1981, insurers offering property coverage in Florida have been required by law to provide coverage for property damage from sinkholes.² In 2007, Florida law was amended to require insurers in Florida to cover only catastrophic ground cover collapse, rather than all sinkhole loss, in the base property insurance policy.³ Catastrophic ground cover collapse is more severe than sinkhole loss. Catastrophic ground cover collapse means geological activity that result in all the following:

1. The abrupt collapse of the ground cover;
2. A depression in the ground cover clearly visible to the naked eye;
3. Structural damage to the covered building, including the foundation; and
4. The insured structure being condemned and ordered to be vacated by the governmental agency authorized by law to issue such an order for that structure.⁴

Insurers must also offer policyholders, for an appropriate additional premium, sinkhole loss coverage covering any structure, including personal property contents.⁵ Such coverage is subject to the insurer's approved underwriting and insurability guidelines. At a minimum, sinkhole loss coverage includes repairing the covered building, repairing the foundation, and stabilizing the underlying land. All property insurers can restrict catastrophic ground cover collapse and sinkhole loss coverage to the property's principal building. However, by law, Citizens Property Insurance Corporation (Citizens)⁶ sinkhole loss coverage does not cover sinkhole losses to appurtenant structures, driveways, sidewalks, decks, or patios. Furthermore, insurers can require an inspection of the property before providing sinkhole loss coverage.

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

Substantial changes to Florida's sinkhole law occurred in 2005, 2006, and 2011.⁷ In 2011, the Legislature reviewed the sinkhole law and enacted comprehensive reforms addressing all areas of the law. Data collected by the Office of Insurance Regulation (OIR) in 2010, before the reforms were enacted, showed a significant increase in the number and cost of sinkhole claims from 2006 to 2010.⁸ These increases impacted the financial stability of property insurers in Florida, including Citizens, and were used by insurers to justify property insurance rate increases.

¹ s. 627.706(2)(b), F.S.

² Ch. 1981-280, Laws of Fla.

³ s. 30, Ch. 2007-1, Laws of Fla.

⁴ s. 627.706(2)(a), F.S.

⁵ s. 627.706, F.S.

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

⁷ Chs. 2005-111, 2006-12, and 2011-39, Laws of Fla.

⁸ *Report on Review of the 2010 Sinkhole Data Call by the Office of Insurance Regulation*, Nov. 8, 2010, http://www.flor.com/siteDocuments/Sinkholes/2010_Sinkhole_Data_Call_Report.pdf (last visited Feb. 7, 2016).

The sinkhole reforms enacted in 2011 were in response to the increasing number and cost of sinkhole claims. The goal of the reforms was to keep sinkhole loss insurance available to homeowners while providing more certainty in sinkhole claims for homeowners and insurers in terms of coverage, costs, repairs, and exposure.

The first complete year the reforms were in effect was 2012.⁹ No data has been collected on an industry-wide basis on the number of claims, claim severity, or claim costs since the reforms were enacted, so their impact on sinkhole claims and costs on an industry-wide basis is unknown. However, Citizens performed a sinkhole study in 2012 to compute the impact of the 2011 reforms on their policies.¹⁰ This study looked at actual sinkhole claim files from Citizens and readjusted the losses and expenses associated with the claims as if the 2011 reforms had been in effect. The actuarial analysis which accompanied the study projected the 2011 reforms would reduce Citizens' expected incurred sinkhole losses for 2013 by almost 55 percent. In Citizens' rate filing for 2014,¹¹ their actuary projected Citizens' sinkhole losses would decrease by over 52 percent relative to what they would have been without the 2011 reforms. The actuary further noted, however, that even with the projected reduction in sinkhole losses, Citizens still has a significant rate deficiency in the sinkhole area. In fact, in 2012, Citizens earned almost \$57 million in sinkhole premium but paid almost \$227 million in sinkhole losses and expenses.

According to data from Citizens,¹² in 2013, new sinkhole claim volume was down 61 percent from 2012. Also, Citizens had 54 percent fewer pending sinkhole claims in 2013 than 2012. Paid indemnity, outstanding indemnity reserves, and loss adjustment expenses paid to date for sinkhole claims filed against Citizens have also decreased in 2013 when compared to 2012. This declining trend continued into 2014 and 2015 and, according to Citizens, is attributable largely to the major sinkhole claims reform enacted in 2011.¹³

Sinkhole Insurance

Current law regarding sinkhole insurance includes the following requirements:

- Every property insurer must provide coverage for catastrophic ground cover collapse;
- Each property insurer must offer coverage for sinkhole loss, for an appropriate additional premium, on any structure including the contents of personal property; and
- A policy for residential property insurance may include a deductible amount applicable to sinkhole losses equal to 1 percent, 2 percent, 5 percent, or 10 percent of the policy dwelling limits, with appropriate premium discounts offered with each deductible amount.

There are four terms in statute¹⁴ that, when read together, describe what is currently meant by sinkhole insurance. These terms are:

1. "Sinkhole" means a landform created by subsidence of soil, sediment, or rock as underlying strata are dissolved by groundwater. A sinkhole forms by collapse into subterranean voids created by dissolution of limestone or dolostone or by subsidence as these strata are dissolved.

⁹ The reforms were effective on May 17, 2011 when the bill (CS/CS/CS/SB 408) was signed by the Governor.

¹⁰ *Citizens Property Insurance Corporation Senate Bill 408 Sinkhole Analysis*, prepared by Insurance Services Office, dated Jul. 19, 2012, and presented at Citizens' Board of Governors Meeting on Jul. 27, 2012, https://www.citizensfla.com/about/mDetails_boardmtgs.cfm?show=PDF&link=/bnc_meet/docs/419/07AH_Citizens_SB408_Sinkhole_Analysis.pdf&event=419&when=Past (last visited Feb. 7, 2016).

¹¹ Information on Citizens' 2014 rate filing is available at <https://www.citizensfla.com/about/mediareources.cfm> (last visited Feb. 7, 2016).

¹² Data is as of the end of September 2013 and is available in meeting materials from the Citizens' Claims Committee meeting on Nov. 14, 2013, available at https://www.citizensfla.com/about/mDetails_boardmtgs.cfm?event=531&when=Past (last visited Feb. 7, 2016).

¹³ *Citizens Property Insurance Corporation Actuarial & Underwriting Committee Recommended Rate Filing Executive Summary*, Jun. 23, 2015 at https://www.citizensfla.com/about/mDetails_boardmtgs.cfm?show=PDF&link=/bnc_meet/docs/604/02_2016_Annual_Recommended_Rate_Filing_Exec_Summary.pdf&event=604&when=Past (last visited Feb. 7, 2016).

¹⁴ s. 627.706(2) (h)(i)(j) and (k), F.S.

2. “Sinkhole activity” means settlement or systematic weakening of the earth supporting the covered building only if the settlement or systematic weakening results from contemporaneous movement or raveling of soils, sediments, or rock materials into subterranean voids created by the effect of water on a limestone or similar rock formation.
3. “Sinkhole loss” means structural damage to the covered building, including the foundation, caused by sinkhole activity. Contents coverage and additional living expenses apply only if there is structural damage to the covered building caused by sinkhole activity.
4. “Structural damage” means a covered building, regardless of the date of its construction, has experienced the following:
 - (a) Interior floor displacement or deflection in excess of acceptable variances as defined in American Concrete Institute (ACI) 117-90¹⁵ or the Florida Building Code, which results in settlement-related damage to the interior such that the interior building structure or members become unfit for service or represents a safety hazard as defined within the Florida Building Code;
 - (b) Foundation displacement or deflection in excess of acceptable variances as defined in ACI 318-95 or the Florida Building Code, which results in settlement-related damage to the primary structural members or primary structural systems that prevents those members or systems from supporting the loads and forces they were designed to support to the extent that stresses in those primary structural members or primary structural systems exceeds one and one-third the nominal strength allowed under the Florida Building Code for new buildings of similar structure, purpose, or location;
 - (c) Damage that results in listing, leaning, or buckling of the exterior load-bearing walls or other vertical primary structural members to such an extent that a plumb line passing through the center of gravity does not fall inside the middle one-third of the base as defined within the Florida Building Code;
 - (d) Damage that results in the building, or any portion of the building containing primary structural members or primary structural systems, being significantly likely to imminently collapse because of the movement or instability of the ground within the influence zone of the supporting ground within the sheer plane necessary for the purpose of supporting such building as defined within the Florida Building Code; or
 - (e) Damage occurring on or after October 15, 2005, that qualifies as “substantial structural damage” as defined in the Florida Building Code.

Under current law, sinkhole insurance means coverage for sinkhole loss which includes “structural damage” caused by “sinkhole activity.” The definition of sinkhole does not include either term. To file a sinkhole claim and recover payment, there must be structural damage to the covered building, including the foundation, caused by sinkhole activity. If a homeowner only has a “sinkhole” as that term is currently defined, the policyholder will not be covered (unless the sinkhole falls within the definition of catastrophic ground cover collapse).

Effect of the Bill

The bill creates a new type of personal lines residential coverage for the peril of sinkhole loss. Among its key features regarding coverage, the bill:

- Authorizes a new line of coverage called “limited sinkhole coverage insurance” that may be offered, but is subject to underwriting;
- Uses applicable definitions from current law to cover “sinkhole loss”;

¹⁵ The American Concrete Institute develops and distributes consensus based standards for concrete design, construction and materials. More information and copies of their standards documents are available at <https://www.concrete.org/aboutaci.aspx> (last visited Feb. 8, 2016).

- Permits policies to include coverage of contents or additional living expenses, which are not required, and limit coverage to stabilization of the building and repair of the foundation; coverage of land stabilization is not required;
- Allows deductibles as agreed by the insurer and insured;
- Allows policy limits as agreed by the insurer and insured, subject to a minimum limit;
- Requires the insured's signed acknowledgement of reading and understanding the policy limitations;
- Requires notice, with prescribed text in uppercase bold 12 point type, that declares that the:
 - Policy is a sub-limit policy, if applicable; and
 - Deductible exceeds the percentage authorized for other sinkhole policies, if applicable;
- Does not requiring form filing; and
- Prohibits an insured from assigning a post-loss claim, except to a property purchaser who acquires a post-loss insurable interest.

Surplus Requirements

New Insurers

To transact insurance in Florida, insurers must apply for a certificate of authority and meet certain surplus requirements. For a new domestic insurer that transacts residential property insurance and is:

- Not a wholly owned subsidiary of an insurer domiciled in any other state, the surplus requirement is at least \$15 million; and
- A wholly owned subsidiary of an insurer domiciled in any other state, the requirement is at least \$50 million.

Effect of the Bill

For a new domestic insurer that *only* transacts limited sinkhole coverage insurance for personal lines residential property pursuant to s. 627.7151, F.S., (a new section created in the bill) the bill lowers the surplus requirement. For those entities, the insurer must possess a surplus of at least \$7.5 million.

Existing Insurers

Under current law, the surplus requirements for existing insurers are different than the requirements for new insurers. For property and casualty insurers, the requirement is \$4 million, except for property and casualty insurers authorized to underwrite any line of residential property insurance. For residential property insurers not holding a certificate of authority before July 1, 2011, the requirement is \$15 million. For residential property insurers holding a certificate of authority before July 1, 2011, and until June 30, 2016, \$5 million; on or after July 1, 2016, and until June 30, 2021, \$10 million; on or after July 1, 2021, \$15 million.

Effect of the Bill

For an existing domestic insurer that *only* transacts limited sinkhole coverage insurance for personal lines residential property pursuant to s. 627.7151, F.S., the bill sets a surplus requirement of \$7.5 million.

Limited Sinkhole Coverage Insurance Rates

Rates for property, casualty, and surety insurance cannot be excessive, inadequate, or unfairly discriminatory.¹⁶ When an insurer submits a rate to the OIR for a full rate review, the OIR uses statutory factors and rate standards found in s. 627.062(2), F.S., to determine if a rate is excessive, inadequate, or unfairly discriminatory. If a limited sinkhole coverage insurer opts to file its limited sinkhole coverage insurance rates with the OIR for approval before using the rates, the rates cannot be excessive,

¹⁶ s. 627.062(1), F.S.

inadequate, or unfairly discriminatory. To make this determination, the OIR will use the same statutory factors and rate standards that it uses for rates for property, casualty, and surety insurance.

Effect of the Bill

The bill allows insurers providing limited sinkhole coverage insurance to develop rates for the coverage two ways:

- Use the rate after filing with and approval by the OIR; and
- Use the rate without filing with or approval by the OIR.

Insurers can only use the second way to develop limited sinkhole coverage insurance rates until October 1, 2019. After this date, all insurers must use the first option which requires a full rate review and approval by the OIR before a limited sinkhole coverage insurance rate can be used.

While the bill allows insurers to use a rate for limited sinkhole coverage insurance without filing it or obtaining approval of it from the OIR, a rate set this way still cannot be excessive, inadequate, or unfairly discriminatory, which is the same rate review standard for rates filed with and approved by the OIR. The insurer writing the limited sinkhole coverage insurance is responsible for ensuring the rate charged meets this requirement.

The bill allows the OIR to examine an insurer's documentation supporting a rate to verify the rate meets the requirement with the insurer paying for the examination. During an examination, the OIR uses the rate factors and standards in current law that apply to property, casualty and surety insurance rates filed with the OIR to determine whether the limited sinkhole coverage insurance rate charged is excessive, inadequate, or unfairly discriminatory. Additionally, the insurer must notify the OIR within 30 days of a rate change for limited sinkhole coverage insurance that was originally set by this method. Setting limited sinkhole coverage insurance rates using this method is similar to what is allowed in current law for rates for flood insurance and certain types of commercial lines risks under s. 627.062(3)(d), F.S.

Limited Sinkhole Coverage Insurance in the Surplus Lines Market

Currently, no insurance coverage is eligible for export to a surplus lines insurer unless it meets certain conditions. The following conditions must be met for export: that an agent has sought coverage from and received three documented rejections from authorized insurers currently writing the same type of coverage; the premium rate is not lower than that in use by the majority of authorized insurers offering the same coverage on similar risks; the policy is not more favorable to the insured than those issued by the majority of authorized insurers writing the same coverage on similar risks; deductibles other than those allowed similar policies; and advisement to the insured that the policy may be available for less from Citizens.

Effect of the Bill

Until July 1, 2020, the bill allows this new sinkhole coverage for personal lines residential property to be written by a surplus lines insurer without satisfying the conditions described above.

Other Regulatory Requirements

In addition to other requirements in the bill, insurers providing limited sinkhole coverage insurance are to notify the OIR at least 30 days before writing sinkhole insurance in this state. They also must file a plan of operation and financial projections or revisions to such plan, as applicable, with the OIR.

B. SECTION DIRECTORY:

Section 1. Amends s. 624.407, F.S., relating to surplus required; new insurers.

Section 2. Amends s. 624.408, F.S., relating to surplus required; current insurers.

Section 3. Creates s. 627.7151, F.S., relating to limited sinkhole coverage insurance.

Section 4. Provides an effective date of July 1, 2016.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The economic impact on the private sector is indeterminate.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not Applicable. This bill does not appear to affect county or municipal governments.

2. Other:

None

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

In its bill analysis¹⁷, the OIR identified several issues of concern. Their comments are as follows:¹⁸

The bill has specific provisions for a domestic residential insurer that solely writes sinkhole coverage but it does not specifically mention a non-domestic insurer. The bill should provide clarity with regard to a non-domestic insurer.

¹⁷ Florida Office of Insurance Regulation, Agency Analysis of 2016 HB 1327, (Jan. 28, 2016).

¹⁸ The agency bill analysis is drafted to HB 1327, as filed; not to the committee substitute. The comments listed are from the original analysis, but relate to provisions that are retained in CS/HB 1327. A revised bill analysis has not yet been received.

This bill proposes the essential deregulation of personal lines sinkhole-only rates until October 1, 2019, which is similar to current statutory language for private flood rates. Applying this provision to new sinkhole-only rates seems to create an inconsistency with companies which already have sinkhole rates on file that have been approved. The result would seem to be that rates for sinkhole-only insurers would be deregulated while the rates for multi-peril personal residential property insurers that include coverage for sinkhole would not. Since insurers already have rates approved for sinkhole coverage, unlike the situation for private flood coverage, it is not clear why suspension of the application of rating statutes for sinkhole-only coverage is necessary or advisable.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 1, 2016, the Insurance & Banking Subcommittee considered the bill, adopted a strike-all amendment, and reported the bill favorably with a committee substitute. The amendment made the following revisions to the bill:

- Authorizing a new line of coverage called “Limited Sinkhole Insurance” that may be offered, but is subject to underwriting; rather than “the peril of sinkholes”;
- Using applicable definitions from current law to cover “sinkhole loss,” instead of “sinkholes”;
- Policies are no longer required to include coverage of contents or additional living expenses;
- Coverage may be limited to stabilization of the building and repair of the foundation; coverage of land stabilization is not required;
- Increasing minimum surplus requirements to \$7.5 million for any new or existing insurers writing limited sinkhole insurance (was \$2.5 million for new and \$1.5 million for existing);
- Allowing deductibles as agreed by the insurer and insured;
- Allowing policy limits as agreed by the insurer and insured, subject to a minimum limit;
- Requiring the insured’s signed acknowledgement of reading and understanding the policy limitations;
- Requiring notice, with prescribed text in uppercase bold 12 point type, that declares that the:
 - Policy is a sub-limit policy, if applicable; and
 - Deductible exceeds the percentage authorized for other sinkhole policies, if applicable;
- Not requiring form filing;
- Prohibiting an insured from assigning a post-loss claim, except to a property purchaser who acquires a post-loss insurable interest;
- Maintaining current law regarding the provision of catastrophic ground cover collapse coverage by Citizens Property Insurance Corporation;
- Removing additional restrictions on the exportation of limited sinkhole insurance to the surplus lines; and
- Removing provisions requiring the Florida Commission on Hurricane Loss Projection Methodology to develop and the Office of Insurance regulation to use sinkhole loss projection models.

The staff analysis has been updated to reflect the committee substitute.