

**HOUSE OF REPRESENTATIVES  
FINAL BILL ANALYSIS**

<b>BILL #:</b>	CS/CS/HB 1327	<b>FINAL HOUSE FLOOR ACTION:</b>	
<b>SPONSOR(S):</b>	Regulatory Affairs Committee; Insurance & Banking Subcommittee; Ingoglia	113 Y's	1 N's
<b>COMPANION BILLS:</b>	CS/CS/SB 1274	<b>GOVERNOR'S ACTION:</b>	Approved

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**SUMMARY ANALYSIS**

CS/CS/HB 1327 passed the House on March 8, 2016, as CS/CS/SB 1274.

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;
- Prohibits Citizens Property Insurance Corporation from issuing limited sinkhole coverage insurance;
- Does not require coverage of loss of personal property or contents; 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;
- Provides specific conditions on the payout of policy limits on claims where the cost of recommended repairs exceed the policy limits;
- Requires insurer payment of repairs to be issued jointly to the insured and repair contractor;
- Does not require form filing;
- Establishes surplus requirements; and
- 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.

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

The bill was approved by the Governor on April 6, 2016, ch. 2016-197, L.O.F., and will become 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:** h1327z1.IBS

**DATE:** April 12, 2016

## I. SUBSTANTIVE INFORMATION

### A. EFFECT OF 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.<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup>

Insurers must also offer policyholders, for an appropriate additional premium, sinkhole loss coverage covering any structure, including personal property contents.<sup>5</sup> 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)<sup>6</sup> 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.<sup>7</sup> 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.<sup>8</sup>

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<sup>1</sup> s. 627.706(2)(b), F.S.

<sup>2</sup> Ch. 1981-280, Laws of Fla.

<sup>3</sup> s. 30, Ch. 2007-1, Laws of Fla.

<sup>4</sup> s. 627.706(2)(a), F.S.

<sup>5</sup> s. 627.706, F.S.

<sup>6</sup> 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.

<sup>7</sup> Chs. 2005-111, 2006-12, and 2011-39, Laws of Fla.

<sup>8</sup> *Report on Review of the 2010 Sinkhole Data Call by the Office of Insurance Regulation*, Nov. 8, 2010, [http://www.floir.com/siteDocuments/Sinkholes/2010\\_Sinkhole\\_Data\\_Call\\_Report.pdf](http://www.floir.com/siteDocuments/Sinkholes/2010_Sinkhole_Data_Call_Report.pdf) (last visited Feb. 7, 2016).

These increases impacted the financial stability of property insurers in Florida, including Citizens, and were used by insurers to justify property insurance rate increases.

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.<sup>9</sup> 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.<sup>10</sup> 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,<sup>11</sup> 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,<sup>12</sup> 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.<sup>13</sup>

## 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 statute that, when read together, describe what is currently meant by sinkhole insurance.<sup>14</sup> These terms are:

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

<sup>10</sup> *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](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).

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

<sup>12</sup> 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](https://www.citizensfla.com/about/mDetails_boardmtgs.cfm?event=531&when=Past) (last visited Feb. 7, 2016).

<sup>13</sup> *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](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).

<sup>14</sup> s. 627.706(2)(h)-(k), F.S.

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.
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) 117-90<sup>15</sup> 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 shear 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:

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<sup>15</sup> 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).

- Authorizes a new line of coverage called “limited sinkhole coverage insurance” that may be offered, but is subject to underwriting;
- Provides personal lines residential coverage of the peril of sinkhole loss;
  - Does not apply to commercial lines residential coverage, commercial lines nonresidential coverage, or excess coverage for the peril of sinkholes;
  - May not be issued by Citizens Property Insurance Corporation;
- Uses applicable definitions from current law to cover “sinkhole loss”;
- Does not require coverage of contents or additional living expenses;
- Allows policy to be limited to coverage of stabilization of the building and repair of the foundation (coverage of land stabilization is not required);
- Permits deductibles as agreed by the insurer and insured;
- Allows policy limits as agreed by the insurer and insured, subject to a minimum limit of \$50,000;
- Requires the insured’s signed acknowledgement of reading and understanding the policy limitations and understanding that the policy is a “repair-only” policy and that it is recommended that the insured consult with a qualified professional concerning the value of potential losses prior to selecting the value of coverage and the deductible;
- Requires notice, with prescribed text in uppercase bold 12 point type, which declares that the:
  - Policy is a sub-limit policy, if applicable; and
  - Deductible exceeds the percentage authorized for other sinkhole policies, if applicable;
- Provides that when the loss exceeds policy limits, the insurer must, consistent with their professional engineer’s recommendation, either:
  - Pay the cost to complete the repairs; or
  - Following the insured having entered into a contract to complete the repairs, pay the cost, not to exceed the policy limits.

However, the insured may seek a lower-cost alternative from their own professional engineer. If they receive a lower-cost repair recommendation and enter into a repair contract to complete repairs under the lower-cost alternative, the insurer must pay for the repair, not to exceed the policy limits. The insurer may make reasonable adjustments to the cost of the lower-cost alternative repair, but they must make them consistent with the engineering requirements of the lower-cost alternative repair recommendation;

- Establishes that, unless the insurer chooses to make repairs in excess of the policy limits, the insured is responsible for the amount of any repair that exceeds the policy limits (this is in addition to their responsibility for the policy deductible);
- Requires payments for repairs to be issued jointly to the insured and repair contractor; and
- Does not require form filing.

## **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;
- 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.<sup>16</sup> 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, 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.

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<sup>16</sup> s. 627.062(1), F.S.

## 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.

## 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.