

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** HB 1937 CS    PCB IN 05-02    Property insurance  
**SPONSOR(S):** Insurance Committee  
**TIED BILLS:** HB 1939                      **IDEN./SIM. BILLS:** SB 1488

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
Orig. Comm.: Insurance Committee	16 Y, 1 N	Callaway	Cooper
1) State Administration Appropriations Committee	8 Y, 1 N, w/CS	Rayman	Belcher
2) Commerce Council			
3)			
4)			
5)			

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**SUMMARY ANALYSIS**

This bill contains numerous provisions relating to property insurance. The bill:

- Allows insurers to include their Florida Hurricane Catastrophe Fund premium in rates for one year only.
- Allows the findings of a hurricane model used by an insurer to support a rate filing to be admissible in the rate filing only under specified circumstances and requires insurers to provide data to the state university research center for use in developing, maintaining, and updating the public hurricane model and protects the trade secret nature of the loss data if trade secrets are disclosed.
- Decreases the percentage of rate filing requiring a public hearing from 25 to 15 percent.
- Adds legislative intent regarding the quality of service provided by Citizens Property Insurance Corporation (Citizens), increases the membership of the Citizens' Board of Governors (Board), changes the appointing entity of the Board, changes the hiring entity of the executive director and senior managers of Citizens, and establishes a Market Accountability Advisory Committee for Citizens.
- Requires an operational audit of Citizens by the Auditor General and requires a report to the Legislature by the Board of Governors of Citizens.
- Amends the method of establishing rates for Citizens under specified circumstances, limits Citizens' coverage on dwellings to \$1 million, specifies the amount of catastrophe reinsurance Citizens must "make its best efforts to procure," and establishes the amount of bonuses given by Citizens to insurers who take policies out of Citizens and into the voluntary market.
- Provides the Office of Insurance Regulation with additional grounds to disapprove a policy form for property and casualty insurance.
- Allows commercial residential insurance policies to be eligible for the property mediation program and allows a first-party claimant/policyholder to file litigation on the property insurance claim before an appraisal of the damage under specified circumstances.
- Defines terms used in sinkhole claims and creates new law relating to a sinkhole database.

Provisions in the bill may reduce the assessment by Citizens. The impact on rates and availability of personal lines residential policyholders is unknown. Costs for commercial residential insurers may increase due to more mediation costs.

Department of Environmental Protection (DEP) estimates the cost for the sinkhole database provisions in the bill will be \$150,000. The Auditor General estimates the cost to conduct an operational audit of Citizens will be \$75,000. These costs will be absorbed within the existing base budgets.

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

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**DATE:** 4/13/2005

The bill is effective on July 1, 2005. The bill's provisions relating to hurricane modeling become effective only if a separate public records and public meetings bill is passed.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

**Provide Limited Government:** The bill requires a public hearing for any residential property rate increase of 15 percent or more, rather than 25 percent. The bill amends current law to allow members of Citizens Property Insurance Corporation (Citizens) to be appointed by the Chief Financial Officer (CFO), the Governor, the President of the Senate, and the Speaker of the House of Representatives instead of appointment by the CFO only. The bill requires the Auditor General to perform an operational audit of Citizens. The bill specifies the amount of reinsurance Citizens is required to “make its best efforts to procure.” The bill requires Department of Financial Services (DFS) to establish and maintain a database of sinkhole claims. The bill expands the authority of OIR to disprove property and casualty insurance forms. The bill expands the types of property insurance policies eligible for the property mediation program run by the DFS.

**Ensure Lower Taxes:** Certain provisions in the bill, such as the limit on Citizens coverage to \$1 million, may reduce assessments on all residential policyholders by Citizens.

**Safeguard Individual Liberty:** The bill prohibits insurers from delaying the recoupment of Florida Hurricane Catastrophe Fund (FHCF) premiums from policyholders over a year as is currently allowed by law. The bill requires the Office of Insurance Regulation (OIR) and the Insurance Consumer Advocate to have access to the assumptions and components of any hurricane model an insurer uses to justify its property insurance rate filing if the results of the model are to be admissible and relevant in a rate proceeding. The bill requires a public hearing for any residential property rate increase of 15 percent or more, rather than 25 percent. The bill requires the appointment of a Market Accountability Advisory Committee for Citizens. The bill provides an alternative way for Citizens to set its rates for personal lines residential insurance in geographic locations OIR determines does not have a reasonable degree of competition. The bill limits the amount of coverage provided by Citizens to \$1 million. The bill expands the authority of OIR to disprove property and casualty insurance forms. The bill expands the types of property insurance policies eligible for the property mediation program run by the DFS. The bill expands the circumstances under which a policyholder can file litigation against an insurer under a property insurance contract without participating in an appraisal of property damage.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Recoupment of Florida Hurricane Catastrophe Fund Premiums by Insurers**

Under current law, insurers are permitted to recoup Florida Hurricane Catastrophe Fund (FHCF) premiums in the premiums they charge to residential policyholders. However, some insurers are not recouping the FHCF premiums paid in the year the premiums are paid. Rather, these insurers are waiting two or more years to recoup FHCF premiums and when the FHCF premiums are recouped, the insurer is recouping them for all the years the premiums have not been recouped by including multiple years of FHCF premiums in one year’s rate filing. This results in a large premium increase for policyholders in one year, as opposed to smaller increases in sequential years.

The bill allows insurers to include in their rates the FHCF premium for one year only. In other words, the bill requires an insurer to recoup the FHCF premium they paid in the premium they charge policyholders for the same year. The insurer is not allowed to hold off recouping FHCF premiums until it results in a large premium increase for policyholders. If an insurer fails to recoup the FHCF premiums paid in a rate filing for a year, the insurer is precluded from recouping the FHCF premiums.

## **Hurricane Modeling**

*Florida Commission on Hurricane Loss Projection Methodology* -- In 1995 the Legislature established the Florida Commission on Hurricane Loss Projection Methodology (Commission) to serve as an independent body within the State Board of Administration.<sup>1</sup> The Commission's role is to adopt findings relating to the accuracy or reliability of the methods, standards, principles, models and other means used to project hurricane losses. The mission of the Commission "is to assess the efficacy of various methodologies which have the potential for improving the accuracy of projecting insured Florida losses resulting from hurricanes and to adopt findings regarding the accuracy or reliability of these methodologies for use in residential rate filings."

The membership of the Commission is designed to equip it with a wide array of expertise in fulfilling its mission. The members include an actuary member from the FHCF Advisory Council, an actuary employed with a property and casualty insurer, an actuary employed by the Office of Insurance Regulation (OIR) who is responsible for property insurance rate filings, the Executive Director of Citizens, the senior employee responsible for FHCF operations, the Insurance Consumer Advocate, the Director of Emergency Management of the Department of Community Affairs, and experts in insurance, finance, statistics, computer system design, and meteorology who are full-time faculty members in the state university system.

The Commission sets standards for loss projection methodology and examines the methods employed in proprietary hurricane loss models used by private insurers in setting rates to determine whether they meet the Commission standards. There are currently four private hurricane loss models that have been determined by the Commission to meet its standards and found acceptable.

The entire Commission is not able to examine, have possession of, or specifically discuss all of the various assumptions and components used in developing the various private industry models because private modeling companies consider certain information a trade secret that could be subject to disclosure under Florida's Sunshine Laws. Instead, the Commission uses a staff of five experts made up of a meteorologist, an engineer, an actuary, a statistician, and a computer scientist known as the "Professional Team" to conduct on-site reviews of proprietary models for the Commission. Representatives from OIR have also been provided access to different proprietary models, but are not permitted to disclose the proprietary aspects of the models.

*Use of Hurricane Models in Rate Filings* --Under current law, an insurer's hurricane loss findings and factors are admissible and relevant in a rate filing, in any administrative or judicial review of a rate filing or in an arbitration held in lieu of an administrative review of a rate filing. Thus, under current law the findings and factors are admissible even if they are not disclosed to OIR in the rate filing. Representatives from OIR stated before the Joint Select Committee on Hurricane Insurance (Joint Select Committee) that a lack of access and ability to challenge the assumptions and components of models approved by the Commission has created difficulty in determining whether the modeling data used by an insurer justifies the insurer's proposed rates pursuant to the standards of the rating laws.

The bill requires insurers to allow OIR and the Insurance Consumer Advocate to access all assumptions and components for the hurricane model the insurer uses in its residential insurance rate filing. It allows the findings of a hurricane model used by an insurer to support a rate filing to be admissible in the rate filing only if OIR and the Consumer Advocate have access to all of the assumptions and components of the model and are not precluded from disclosing the assumptions and components in a rate proceeding.

*Public Hurricane Model* --In order to improve the accuracy of hurricane risk assessments, the state has authorized the development and creation of a *public* hurricane loss projection model. The model has

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<sup>1</sup> s. 627.0628, F.S. (2004).

been developed to comply with the standards set by the Commission using expert personnel from the state university system, and is maintained at the International Hurricane Research Center at Florida International University (FIU). The model is currently being tested and externally reviewed, and is expected to be completed and released by May 2005.

The public model will help project annual expected insured residential losses in Florida as well as provide calculations for hypothetical scenarios. This should yield multiple benefits by providing a check on the methods and results of proprietary models, making loss modeling available for smaller insurers, and by helping the state evaluate the insurance risk faced by the FHCF.

Because the process of testing the public model has been slowed by the failure of some insurers to timely provide insurance policy and claims data the bill requires insurers to provide data in writing to the state university research center (currently FIU) for use in developing, maintaining, and updating the public hurricane model within 30 days of receipt of a written request for data. The bill also protects the trade secret nature of the loss data if trade secrets are disclosed to the state university research center (currently FIU).

### **Public Hearings for Rate Filings**

Under current law, a public hearing must be held on any rate filing for residential property insurance where the percentage of rate increase exceeds 25 percent and that is based in whole or in part on data from a computer model.<sup>2</sup> Recently, two public hearings were held on rate filings requested on homeowner's and mobile homeowner's policies by Nationwide Insurance Company of Florida. In the recent Nationwide rate filings, the average rate change varied by county, but resulted in an average statewide rate increase for homeowners' policies of 28.2%.<sup>3</sup> The average statewide rate increase for mobile homeowner's policies was 100%, although the rate change varied by county.<sup>4</sup>

The bill decreases the percentage of rate filing requiring a public hearing from 25 to 15 percent, if the rate filing is based on a computer model.

### **Citizens Property Insurance Corporation**

*General Background*--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) which covers 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 January 31, 2005, Citizens provided coverage to 814,081 policyholders, making Citizens the second largest insurer in Florida. The numbers of policyholders in the three accounts are: PLA -- 354,622; CLA -- 3,650; and HRA -- 455,809. Citizens' projections for the 2005 hurricane season are that the HRA is exposed to a **\$7.6 billion** probable maximum loss (PML) for a 100-year storm, and the combined PLA/CLA faces an additional **\$2 billion** 100-year PML.

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<sup>2</sup> s. 627.0629(7), F.S. (2004). Rule 69O-166.051, F.A.C. also contains this requirement.

<sup>3</sup> Media Release from Department of Financial Services dated February 4, 2005 on file with the Insurance Committee.

<sup>4</sup> Id.

The High-Risk Account provides windstorm only coverage. Citizens provides coverage in specially designated areas which have been determined to be particularly vulnerable to severe hurricane damage. In these "wind only" zones, private insurers may offer other peril insurance, but are not required to provide windstorm coverage. For the HRA policies in effect on January 31, 2005, Citizens reports \$699 million generated in premiums, representing an exposure of \$133.9 billion. The premiums generated by the HRA policies account for 61 percent of all premiums generated and represents 68 percent of Citizens' total exposure.

In 2004, Citizens' policyholders were impacted by all four hurricanes hitting Florida. Prior to the hurricane season, Citizens had a surplus of about \$1.1 billion for its High Risk Account and \$700 million for the PLA/CLA combined. For the 2004 storms, Citizens losses are currently estimated at about \$2.4 billion, primarily impacting the High Risk Account. Pending final audit results for 2004, Citizens had a surplus of about \$1.3 billion in its HRA and its losses are estimated at \$1.8 billion, resulting in an estimated deficit of \$525 million. This may require about a 7 percent, one-time regular assessment on property insurers to fund this deficit, which the insurer may then recoup from its policyholders. For example, this would be about a \$70 surcharge for a policy with a \$1,000 annual premium.

For its other two accounts, the PLA/CLA combined had an estimated \$602 million in losses in 2004, which can be paid out of its 2004 surplus of about \$700 million, so assessments do not appear to be necessary for these accounts. All of these estimates are still preliminary as losses continue to develop and final audits are completed.

As of March 17, 2005, Citizens reports that 118,408 claims have been filed for the four hurricanes, with Hurricane Frances being responsible for 43 percent of all claims. As of March 17, 2005, Citizens has closed 95 percent of its claims. Citizens has closed 97 percent of the claims from Charley, 96 percent from Frances, 92 percent from Jeanne and 94 percent from Ivan.<sup>5</sup>

On December 1, 2004, in response to complaints concerning Citizens' claims handling, claim delays and consumer relations, Chief Financial Officer Gallagher (CFO) created the Task Force on Policyholder Services and Relations to Citizens Property Insurance Corporation (Task Force) with the goal of making recommendations to Citizens for improving customer service and returning policies to the private insurance market. On December 6, 2004, the CFO requested Citizens provide him a detailed remediation plan outlining Citizens' available adjusting resources for outstanding claims; a process to inspect and make reasonable efforts to settle, by December 31, 2004, one hundred percent of all claims filed to date; and a framework for effective, efficient, and measurable resolution of consumer complaints.<sup>6</sup> Citizens responded with a detailed remediation plan on December 10, 2004.<sup>7</sup>

As of mid-March 2005, the Task Force has met six times, receiving testimony from a wide variety of stakeholders. The Task Force is made up of representatives from the Florida Association of Insurance Agents, the Florida Bankers Association, the Florida Association of Realtors, the Florida Association of Insurance and Financial Advisors, the Professional Insurance Agents of Florida, the Latin American Association of Insurance Agencies, the Office of Insurance Consumer Advocate, DFS, OIR, and Citizens.

To date, the following recommendations for legislative action have been adopted by the Task Force:<sup>8</sup>

- The Legislature consider clarifying the role of Citizens as a permanent safety valve for Florida property owners.

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<sup>5</sup> Presentation by Citizens to the Task Force on March 23, 2005 available at [http://www.fldfs.com/GeneralCounsel/Task%20Force%2023\\_23\\_05%20.pdf](http://www.fldfs.com/GeneralCounsel/Task%20Force%2023_23_05%20.pdf) (last visited on March 27, 2005).

<sup>6</sup> Letter from the CFO to Mr. Robert L. Ricker, President and Executive Director of Citizens Property Insurance Corporation dated December 6, 2004 on file with the Insurance Committee.

<sup>7</sup> Letter from Citizens Property Insurance Corporation to the CFO dated December 10, 2004 on file with the Insurance Committee.

<sup>8</sup> Minutes from Task Force meeting on February 9, 2005 available at <http://www.fldfs.com/GeneralCounsel/Minutes%20February%2009.pdf> (last visited March 27, 2005).

- The Legislature consider an interim study to determine if Citizens' mission should be revised to a model similar to the federal flood insurance program.
- The Legislature authorize Citizens to implement underwriting rules and incentives, enhanced building protection, exclusions for unprotected parts of the building structure, etc.
- The Legislature should consider enacting an initial cap of \$1,000,000 of coverage in the high-risk pool that is the same as the cap for personal lines coverage and include a provision for increases to the cap in accordance with an appropriate inflation index.
- The Legislature consider enacting a standardized Building Code for new construction that requires all properties throughout the State of Florida to meet the most stringent standard that is currently required anywhere in the State.
- The Legislature should require Citizens to impose a 30-day waiting period from the time a policy is bound before coverage is effective, except for newly completed construction, arms length real property transfers, and other exemptions permitted under the National Flood Insurance Program.
- The Legislature should require Citizens to withhold any premium on cancellations unless then policy is cancelled due to issuance of policy in voluntary market or property is sold.
- The Legislature should address retention limits at the Florida Catastrophe Fund to permit more private admitted carriers into the market and expand the capacity for Citizens and currently admitted carriers.
- The Legislature should require all Citizens' residential dwelling and commercial/residential (condominium) policyholders whose properties are in the flood zone to also have a flood policy, if available through the National Flood Insurance Program.
- The Legislature should amend the valued policy law so that any claim proceeds received by the policyholder from any other carrier shall be offset against the amount paid under the policy.
- The Citizens Board should modify the incentive to insurers who take policies out of Citizens by ensuring that companies only earn a commission when they take out homeowners policies that include windstorm coverage, for a minimum of five (5) years.
- The Legislature should require that insurers that do not write windstorm coverage take a percentage of wind risk through a quota-share arrangement so that Citizens can reduce the need for the use of third-party adjusters.

The bill adds legislative intent to s. 627.351(6)(a), F.S., stating Citizens should provide service to its policyholders, applicants, and agents with the same quality as insurers in the voluntary market provide their policyholders, applicants, and agents. The legislative intent added also states OIR should hold Citizens to the same service standards applied to the voluntary market.

*Board of Governors*-- Citizens operates under the direction of a 7-member Board of Governors, all appointed by the Chief Financial Officer for 3-year terms, representing geographically diverse regions of the state.

The bill changes current law by increasing the membership of the Board of Governors from 7 to 8 members. It also changes the appointing entity from the CFO only to the CFO, Governor, President of the Senate, and the Speaker of the House of Representatives. Each appointing entity will appoint two members of the Board of Governors, effective August 1, 2005. The bill changes the hiring entity of the executive director and senior managers of Citizens from the CFO only to the Board of Governors. Citizens currently employs 7 senior managers. The executive director maintains the authority to employ other Citizens' staff, but the approval of the other staff employed is changed from approval by the CFO only to approval by the CFO and Board of Governors.

Although not required by statute, Citizens also has numerous committees, such as the audit committee, the actuarial committee, the claims committee, and the underwriting committee, on which members of

the Board of Governors serve.<sup>9</sup> The statute, however, requires the Chief Financial Officer to appoint a technical advisory board to provide information and advice to the Board of Governors.<sup>10</sup> According to representatives of the Florida Association of Insurance Agents, the technical advisory board primarily provided input during the formation and organizational period of Citizens.<sup>11</sup>

The bill establishes a Market Accountability Advisory Committee (Market Advisory Committee) for Citizens. The purpose of the Market Advisory Committee is to provide the Board of Governors with information about the voluntary residential property market, such as rates, customer service, and depopulation. Other residual markets, such as the Automobile Joint Underwriting Association, the Florida Workers' Compensation Joint Underwriting Association, the former FWUA, and the former FRPCJUA have similar advisory committees to provide this type of information to them.<sup>12</sup>

Membership of the Market Advisory Committee is composed of representatives of insurance agents, insurers, the Office of Insurance Regulation, consumers, realtors, and bankers. Members of the Market Advisory Committee will serve 3-year terms. The Market Advisory Committee must report to Citizens at each Board of Governors meeting.

*Required Report and Operational Audit*—The bill requires the Board of Governors of Citizens to submit a report to the Legislature by February 1, 2006, which would include findings and recommendations regarding the number of policies and premium of Citizens, and projections for future policy and premium growth; the effectiveness of this act in improving availability of coverage in Florida; projected deficits or surpluses and possible funding mechanisms to ensure the solvency of the plan; an explanation as to Citizens' purchase of catastrophe reinsurance and if such reinsurance was not purchased, an explanation as to why the purchase was not made; and recommendations to the Legislature relating to the operations of Citizens. A similar report was required from the Board of Governors for the Florida Workers' Compensation Joint Underwriting Association in 2003.<sup>13</sup>

The bill requires the Auditor General to conduct an operational audit and to submit the findings to the Legislature by February 1, 2006. The audit must include an analysis of Citizens' infrastructure, claims service, claims handling, and take-out bonuses and programs. It must also include an analysis of Citizens' costs associated with the administration and servicing of its policies and policy alternatives for the Legislature to consider. The Auditor General was required to do a similar operational audit in 2004 of the Florida Workers' Compensation Joint Underwriting Association.<sup>14</sup>

*Rates for Citizens* -- In order to assure that Citizens rates are not competitive with the voluntary market, the current law requires that Citizens' rates for its Personal Lines Account be actuarially sound and that 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.<sup>15</sup>

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 OIR to jointly develop a wind-only ratemaking methodology to meet this purpose, for rates effective on or after July 1, 2004, required to be reported to

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<sup>9</sup> The plan of operation for Citizens requires the Chair of the Citizens Board of Governors to appoint an executive committee, an investment committee, and an audit committee. The plan of operation also allows the Chair of the Citizens Board to establish other committees. The plan of operation can be found at: <http://www.citizensfla.com/pdfs/planofoperation.pdf> (last visited March 27, 2005).

<sup>10</sup> s. 627.35(6)(c)4., F.S. (2004).

<sup>11</sup> See 300 Words (more or less) about a Market Conduct Advisory Committee for Citizens prepared by Florida Association of Insurance Agents on file with the Insurance Committee.

<sup>12</sup> *Id.*

<sup>13</sup> See Section 41, Ch. 2003-412, L.O.F.

<sup>14</sup> See, Section 3, Ch.2004-266, L.O.F.

<sup>15</sup> s. 627.351(6)(d)2., F.S. (2004).

the President of the Senate and Speaker of the House by January 31, 2004.<sup>16</sup> The report was filed and outlined a wind-only rate methodology that uses a variation of the “Top 20” approach mandated for personal residential multi-peril policies.

The requirement for Citizens to charge the highest average rates in a county has been questioned, particularly for those areas where a reasonable degree of competition does not exist. In such areas, consumers may have no option for coverage other than Citizens, arguably making it unnecessary for the law to require an artificially high rate to prevent price shopping, rather than simply requiring rates to be actuarially sound. But, the lack of competition in an area may also indicate that insurers do not perceive current rate levels to be adequate to profitably write coverage. It is also argued that the depleted surplus of Citizens after the 2004 hurricanes and its projected 100-year probable maximum loss of \$7.6 billion for the HRA and \$2 billion for the PLA/CLA, are reasons not to make changes to the current rating requirements for Citizens.

The Insurance Consumer Advocate believes the Legislature should consider amending the statutory requirement that Citizens’ rates be above the voluntary market and consider whether actuarial soundness, alone, is a more appropriate means for establishing rates.<sup>17</sup> According to his testimony, many of the Citizens’ policyholders he has talked with did not “shop their way into Citizens coverage.” Rather, they became Citizens’ policyholders because they had no other choice in residential insurance coverage. Thus, the Consumer Advocate believes these policyholders should not be forced to pay an insurance premium set to keep them out of Citizens when in actuality they were forced in to Citizens by the market.

The bill changes the way Citizens sets rates for its Personal Lines Account and High Risk Account. Under current law, rates for Citizens cannot be competitive with the private market and the bill provides an exception to this requirement for property located in counties for which OIR determines that a reasonable degree of competition does not exist.

For the Personal Lines Account, Citizens must currently charge the highest average rates in the county compared to the 20 insurers with the greatest written premium in the state. This requirement would no longer apply in any county for which OIR determines that a reasonable degree of competition does not exist for personal lines policies.

Regarding the High Risk Account, Citizens is also currently required to ensure that its rates for personal lines policies in the High-Risk Account are not competitive with the private market. The current rating plan utilizes a variation of the “top 20” rating comparison used for the Personal Lines Account. The bill changes current law by providing that this requirement would not apply in any county for which OIR determines that a reasonable degree of competition does not exist for personal lines residential policies in the area of that county eligible for wind-only coverage. In such counties, for both accounts, Citizens would be required to charge rates that are actuarially sound and not excessive, inadequate, or unfairly discriminatory and be subject to the rating law that applies to all property and casualty insurers.

The Financial Services Commission is given authority to adopt rules establishing criteria for determining whether a reasonable degree of competition exists for personal lines residential policies. Beginning October 1, 2005, and each 6 months thereafter, OIR must determine and identify those counties for which a reasonable degree of competition does not exist.

*Coverage Limits for Citizens* -- Although not specified by statute, Citizens’ current plan of operation has a maximum policy limit of \$1 million for homeowner policies issued in its Personal Lines Account (homeowners and other residential policies issued statewide). This account also limits coverage to \$100,000 for mobile homes, \$200,000 for condominium units, and \$100,000 for tenants policies.

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<sup>16</sup> s. 627.351(6)(d)3., F.S. (2004).

<sup>17</sup> Written testimony submitted by the Insurance Consumer Advocate to the Joint Select Committee on Hurricane Insurance on January 14, 2005 on file with the Insurance Committee.

However, there is no upper limit for residential (wind-only) policies issued in Citizens' High Risk Account (windstorm only policies issued in eligible coastal areas).

At year end 2004, of the 453,765 policies in the HRA, 5,705 had policy limits at \$1 million or above. These policies had a total insured value of about \$13 billion, or about 10.8 percent of the insured value for the HRA. Citizens estimates its probable maximum loss in 2004 in the HRA was \$6.7 billion, which would have been reduced by \$700 million, or 10.4 percent, if personal residential policies risks above \$1 million were excluded.

If coverage for homes valued in excess of \$1 million was not available from Citizens and was not available from an authorized insurer, a policyholder would then have to look to the surplus lines market for coverage.<sup>18</sup> The Florida Surplus Lines Service Office (FSLSO) reported that there is capacity and interest in the surplus lines market in writing high-value dwellings, but windstorm deductibles are typically 5 or 10 percent and sinkhole coverage is typically excluded. Testimony before the Joint Select Committee and before the Insurance Committee confirmed coverage for homes valued in excess of \$1 million is available in the surplus lines market.<sup>19</sup>

The bill provides express statutory language limiting Citizens' coverage on dwellings in the Personal Lines Account and the High-Risk Account to \$1 million.

*Reinsurance--* Reinsurance is insurance coverage procured by an insurer for its own protection. In Florida, all insurers who write residential property insurance in Florida are required to buy reimbursement coverage (reinsurance) on their residential property exposure through the Florida Hurricane Catastrophe Fund (FHCF). The FHCF is administered by the State Board of Administration and is a tax-exempt source of reimbursement to property insurers for a selected percentage (45, 75, or 90 percent) of hurricane losses above the insurer's retention/deductible.

To help protect the solvency of the insurance company in cases of catastrophe, many insurance companies buy private reinsurance in the voluntary market to supplement the reinsurance it must purchase through the FHCF. Each insurance company makes a business decision whether to purchase additional private reinsurance to cover potential claims not covered by its reinsurance purchased through the FHCF. The decision is unique to each company. An insurer's decision whether to purchase private reinsurance is based, in part, on its budget, its required reserves, the risk it is willing to take, its underwriting strategy, and other factors.

Because Citizens writes residential property insurance in Florida, it is required to buy reinsurance through the FHCF. Additionally, under current law, Citizens' plan of operation must require Citizens to "make its best efforts to procure" reinsurance at reasonable rates.<sup>20</sup> In 2004, Citizens purchased reinsurance through the FHCF, although it did not sustain adequate losses for any one hurricane to meet its FHCF retention and thus qualify for reimbursement from the FHCF. Additionally, Citizens did not purchase reinsurance in the private market to supplement the reinsurance required to be purchased through the FHCF indicating such a purchase was not cost efficient and Citizens' focus is on tax-exempt financing in lieu of purchasing private reinsurance.<sup>21</sup> Citizens has never purchased reinsurance other than its FHCF coverage.

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<sup>18</sup> Surplus lines insurance is defined as insurance coverage provided by an insurer that is not licensed in a particular state, but nonetheless permitted to do business in the state because the particular coverage offered is not available from a licensed company. The Florida Insurance Code contains specific financial and other requirements that unauthorized insurers must comply with in order to become eligible surplus lines insurers. Surplus lines insurance is not subject to Florida regulation of rates or forms and there is no insurance guaranty fund protection if the insurer becomes insolvent.

<sup>19</sup> Testimony at the Insurance Committee meeting on March 24, 2005.

<sup>20</sup> s. 627.351(6)(c)9., F.S. (2004).

<sup>21</sup> Testimony of Robert Ricker, Executive Director of Citizens Property Insurance Corporation, before the Insurance Committee on March 24, 2005.

The bill amends current law to specify the amount of catastrophe reinsurance Citizens must “make its best efforts to procure.” The amount specified in the bill is reinsurance to cover Citizens 100-year probable maximum loss.<sup>22</sup>

*Take-out Bonuses:* The current law expresses legislative intent to provide a variety of financial incentives to encourage the replacement of policies written in Citizens with policies written by authorized insurers at approved rates. There is specific authority for Citizens, as there was for the Residential Property and Casualty Joint Underwriting Association, to pay a “take-out bonus” to insurers of up to \$100 for each policy removed from Citizens, under certain conditions. However, Citizens, like the RPCJUA before it, has implemented greater bonuses under conditions approved by its board and the OIR, based on a broader grant of authority to adopt programs and incentives for the reduction of both new and renewal writings.

Prior to February 15, 2005, Citizens provided a take-out bonus ranging from 12.5 to 17.0 percent of the premium for policies removed from the Personal Lines Account, subject to requirements for taking out a specified minimum number of policies and a specified minimum percentage in Miami-Dade, Broward, or Palm Beach counties. The take-out bonus for policies taken out of the High Risk Account was 25% for a minimum of 20,000 policies taken out. Insurers were required to insure a take-out policy for three years as a condition of receiving the bonus, which is held in an escrow account until that time.

According to Citizens, in 2004, four insurers removed more than 158,416 policies from Citizens, including 145,959 policies in the Personal Lines Account and 12,457 policies in the High Risk Account.

On February 15, 2005, the Citizens’ Board of Governors voted to change the way that takeout bonuses were paid by Citizens due to concern about whether the take-out structure in place was the best structure to encourage responsible depopulation of Citizens. Currently, Citizens pays takeout bonuses as follows:

- A flat dollar per policy bonus of \$100, instead of a percentage of premium bonus;
- Requires the takeout insurer to keep policies out for 5 years, instead of 3 years, in order to receive the takeout bonus amount;
- Requires that a pro rata bonus, instead of the full amount of bonus, would be earned by a takeout insurer if the insurance policy was voluntarily cancelled by the policyholder.

As of March 22, 2005, no policies have been removed from Citizens under the new takeout bonuses.

Citizens reports that as of March 25, 2005, Citizens and the former RPCJUA have paid 27 different insurers a total of \$119 million to take out slightly more than 1 million policies. An additional \$67.5 million is currently held in escrow for six insurers taking out an additional 267,075 policies that have not yet been insured for three years.

The bill amends current law by requiring Citizens to provide takeout bonuses to each carrier removing policies from the Personal Lines Account. The bill specifies a minimum per-policy bonus of 12.5% of written premium for a minimum of 10,000 policies removed from Citizens with wind coverage in coastal counties, 15% of written premium for a minimum of 30,000 policies removed from Citizens with wind coverage in coastal counties, and 17.5% of written premium for a minimum of 50,000 policies removed from Citizens with wind coverage in coastal counties. The insurer taking policies out of Citizens must renew the policies taken out for three years in order to receive the bonus. The bill provides circumstances allowing the insurer to qualify for the bonus even though the policy taken out of Citizens is cancelled or voluntarily terminated after it is taken out.

### **Grounds for Disapproval of Policy Forms**

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<sup>22</sup> Probable maximum loss is defined as the highest expected dollar value of loss from a given peril at a given probability. For example, if an insurer has a 100-year hurricane probably maximum loss of \$1 billion, this means that \$1 billion is the highest loss the insurer expects from a hurricane the probability of which is 1 percent.

The bill provides OIR with the authority to disapprove a policy form for property and casualty insurance if it contains provisions that are unfair, inequitable, contrary to public policy, or encourage misrepresentation in other lines of insurance. Under current law, OIR has similar authority for disapproval of policies for health insurance.<sup>23</sup>

### **Mediation Program for Resolving Property Insurance Disputes**

A property mediation program is established under the statutes and administrative rules.<sup>24</sup> The mediation program is available to all first-party claimants and insurers prior to commencing the appraisal process set forth in an insurance policy or commencing litigation under the policy. The mediation program applies to personal residential coverages but not to commercial residential coverages, commercial coverages, to private passenger motor vehicle insurance coverages, to disputes relating to liability coverages in property insurance policies, or to coverages under policies issued by the National Flood Insurance Program.

Most personal residential insurance claims are eligible for the mediation program.<sup>25</sup> Any party to a property insurance dispute can request mediation. Specific mediation procedures and timeframes for mediation are set forth in Rule 69B-166.031, F.A.C.

After the 2004 hurricane season, the Department of Financial Services established, by emergency rule, a special mediation program for personal lines residential insurance claims resulting from Hurricane Charley, Hurricane Frances, Hurricane Ivan, Hurricane Jeanne, and Tropical Storm Bonnie. The emergency rule created procedures for notice of the right to mediation, request for mediation, assignment of mediators, payment for mediation, conduct of mediation, and guidelines for the quality repair of residential property damage. Commercial residential property insurance policies were excluded from the mediation program as they are under the statutorily created property mediation program.

The bill amends current law to allow commercial residential property insurance policies to be eligible for the property mediation program established in s. 627.7015, F.S., rather than the mediation program only covering personal residential insurance policies.

Under current law, a first-party claimant/policyholder must participate in a contractual loss appraisal process of property loss damage before litigation can be filed unless an insurer requests mediation under the property mediation program and the results of the mediation are rejected by either party. The bill expands current law to allow a first-party claimant/policyholder to file litigation on the property insurance claim before an appraisal of the damage in cases where the insurer does not notify a first-party claimant/policyholder of his or her right to participate in the mediation program.

### **Sinkholes**

In the early 1980s, the Florida Legislature began including sinkholes and related problems in Part X of chapter 627, F.S., the laws governing property insurance contracts. In 2004, the Legislature directed OIR to pay for a study of sinkholes and their impact on the insurance industry in the state.<sup>26</sup> The law specifies that the Department of Risk Management of the Florida State University College of Business conduct the study. A preliminary report on sinkholes was submitted to the Legislature and OIR February 1, 2005, with a finalized report, including recommendations for legislative action, submitted April 1, 2005.

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<sup>23</sup> See s. 627.411(1)(f)2., F.S. (2004).

<sup>24</sup> s. 627.7015, F.S. (2004); 69B-166.031, F.A.C.

<sup>25</sup> See s. 627.7015(9), F.S. (2004) and 69B-166.031 (2)(b), F.A.C. for claims that are not eligible for mediation.

<sup>26</sup> s. 627.7077, F.S.

As part of its investigation and information gathering, members of the Joint Select Committee heard both from insurers and representatives of Citizens regarding the problem of sinkholes. Among the issues highlighted for the Joint Select Committee were the cost to insure against sinkhole-related losses and the increasing costs to remedy damage caused to insured property by sinkholes. Both Citizens and private insurers testified to the Joint Select Committee that the costs associated with sinkholes and property insurance adversely impact both the availability and affordability of homeowner insurance.

Testimony to the Joint Select Committee revealed that in the Tampa Bay area private insurers are non-renewing policies and not writing new policies due to the exposure to sinkhole claims. As a result, many homeowners in this area have been forced to obtain coverage from Citizens. Citizens reported to the committee that since 2001, the number of homeowner policies in the Tampa Bay area has dramatically increased from 1,012 policies as of 12/31/2001 to 146,901 policies as of 11/30/2004. Citizens has increased its homeowners policies in Dade, Broward, and Palm Beach counties by 115 percent during the same period, while its total homeowners policies in all other regions of the state have increased by 69 percent for the same time period.

Insurers testifying before the Joint Select Committee also indicated a concern about the best method for remediation of sinkhole damage; how to prove property damage results from a sinkhole rather than from ground settling, soil type, or other geological occurrence; and the responsibility to pay the costs for sinkhole testing and remediation, among other related considerations. The lack of a statutory definition of "sinkhole" in the Insurance Code was discussed in the Joint Select Committee. The bill amends current law by defining "sinkhole," a previously undefined term in the Insurance Code. The bill also amends current definitions of "sinkhole activity" and "sinkhole loss."

Under current law, every insurer authorized to transact property insurance must make sinkhole coverage available to policyholders. Current law requires insurers to make an initial inspection of the sinkhole claim once the claim is filed with the insurer. If structural damage is discovered in the initial inspection, then the insurer must obtain a written certification from a qualified individual that the cause of the claim is not sinkhole activity in order to deny the claim. 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. The bill does not change current law regarding coverage for sinkhole claims, investigation of sinkhole claims, or nonrenewal of property insurance policies as a result of a sinkhole claim.

The bill creates new provisions in the law relating to a sinkhole database. The bill requires DFS, in consultation with the Florida Geological Survey and the Department of Environmental Protection (DEP), to implement a statewide automated database of sinkholes and related activity. The content of the database will be determined by DFS with agreement from DEP and will be managed and maintained by DFS unless DFS contracts the management and maintenance to another entity. The DFS is given authority to require insurers to report past and present sinkhole claims. The DEP must investigate reports of sinkhole activity and report its findings to the database. The DFS is given rulemaking authority to implement rules relating to the sinkhole database. The DEP, in consultation with DFS, is required to submit a report of activities relating to the sinkhole database to the Governor, the Speaker of the House, the President of the Senate, and the CFO by December 31, 2005.

#### C. SECTION DIRECTORY:

Section 1: Amends s. 627.062, F.S.; relating to insurers' ability to recoup FHCF premiums from premiums charged to policyholders.

Section 2: Amends s. 627.0628, F.S.; relating to disclosure of an insurer's hurricane model and assumptions and components of the model to OIR and the Insurance Consumer Advocate in a rate filing and use of the hurricane model and its associated assumptions and components in a rate proceeding.

Section 3: Creates s. 627.06281, F.S.; relating to reporting of hurricane loss data and hurricane exposure data to OIR or a type I center within the state university system.

Section 4: Amends s. 627.0629, F.S.; relating to public hearings for rate filings.

Section 5: Amends s. 627.351, F.S.; providing additional legislative intent for Citizens; relating to coverage limits for Citizens; changing the membership of the Board of Governors of Citizens and the appointing entities; requiring the establishment of a Market Accountability Advisory Committee for Citizens; specifying amounts of "take-out bonuses;" specifying circumstances where an insurer can qualify for a "take-out bonus;" deleting obsolete language; amending the method of establishing rates for Citizens under specified circumstances.

Section 6: Amends s. 627.411, F.S.; adding additional grounds for OIR to disapprove forms.

Section 7: Amends s. 627.7015, F.S.; including an additional type of insurance eligible for the property mediation program.

Section 8: Amends s. 627.706, F.S.; adding a definition and amending definitions relating to sinkhole insurance..

Section 9: Creates s. 627.7065, F.S.; providing legislative findings; requiring the establishment of a statewide sinkhole database; providing for the maintenance and update of the sinkhole database; requiring a report by DEP on sinkhole activity; giving DFS rulemaking authority to enact rules relating to the sinkhole database.

Section 10: Creates an unnumbered section; requiring the Auditor General to conduct an operational audit of Citizens; providing a deadline for reporting the audit findings; providing audit requirements.

Section 11: Creates an unnumbered section; requiring the Board of Governors of Citizens to prepare a report for the Legislature; providing a deadline for the report submission; providing report requirements.

Section 12: Provides sections 2 and 3 are not effective until the passage of HB1939 or substantially similar legislation.

Section 13: Providing an effective date of July 1, 2005 unless otherwise specified.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

1. Revenues:

None.

2. Expenditures:

See D. FISCAL COMMENTS.

### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

**Citizens Property Insurance Corporation**

*Rates for Citizens*--There is an unknown impact on rates resulting from requiring Citizens to charge actuarially sound rates, rather than the highest average rates in the county compared to the top 20 insurers, in those areas where OIR determines a reasonable degree of competition does not exist. Citizens reports that this will not necessarily lower rates, and could even increase rates in certain areas. By using the current top 20 rating formula, Citizens has reportedly not necessarily charged a rate as high as the actuarially indicated rate in all areas. It is also unknown which counties or areas would be determined by OIR to lack a reasonable degree of competition. But, OIR reports that as of June 30, 2004, Citizens writes 93 percent of the total policies in Monroe County that include wind coverage and writes 48 percent of the total policies in Dade County that include wind coverage. Because this includes policies being renewed, it may understate the lack of competition for new policies.

*Coverage Limits for Citizens*--Policyholders of homes valued in excess of \$1 million will be ineligible for coverage from Citizens. If coverage is not available from an authorized insurer, a policyholder would then look to the surplus lines market. The Florida Surplus Lines Service Office reported that there is capacity and interest in the surplus lines market in writing high-value dwellings, but windstorm deductibles are typically 5 or 10 percent and sinkhole coverage is typically excluded. Deductibles 5 to 10 percent and sinkhole exclusions may increase out-of-pocket costs for policyholders.

*Reinsurance*--Although the bill does not mandate that Citizens purchase reinsurance, it directs Citizens to use its best efforts to purchase reinsurance to cover its 100-year probable maximum loss. Citizens provided an estimate that for its High Risk Account (HRA), which has a zero surplus, this may cost a total of \$743 million to cover its estimated \$7.6 billion 100-year PML, which includes its estimated FHC premium of \$135 million. This total premium is almost the entire 2005 estimated written premium of \$754 million for Citizens' HRA. For its Personal Lines Account/Commercial Lines Account, which has a \$235 million surplus, the 100-year PML is \$2.2 billion. Citizens estimates that it would cost \$151.5 million (including a \$35 million FHC premium) to purchase this level of reinsurance, as compared to its estimated \$1.1 billion estimated premium for 2005 for these accounts.

*Take-out Bonuses*—The bill's delineation of the amount of take-out bonuses Citizens must pay to insurers who assume Citizens' policies will likely increase the amount Citizens pays for bonuses. Currently, Citizens pays a bonus of \$100 per policy. The bill allows for a bonus of 12.5%, 15% or 17.5% of written premium of the policies taken out. The percentage of bonus the insurer qualifies for is dependent on the number of policies the insurer takes out of Citizens.

A specific amount of money to be paid in "take-out bonuses" by Citizens due to the bill's bonus structure has not yet been determined. It will depend on how many policies insurers take out of Citizens. However, because the bonus structure provided in the bill is likely more lucrative than Citizens' current bonus structure, insurers may be encouraged to remove policies from Citizens in greater amounts than in the past.

*Assessments by Citizens*--Limiting the coverage for Citizens to \$1 million should reduce the exposure of Citizens which in turn may decrease the likelihood of assessments to residential policyholders. At year end 2004, of the 453,765 policies in the HRA, 5,705 had policy limits at \$1 million or above. These policies had a total insured value of about \$13 billion, or about 10.8 percent of the insured value for the HRA. Citizens estimates its probable maximum loss in 2004 in the HRA was \$6.7 billion, which would

have been reduced by \$700 million, or 10.4 percent, if personal residential policies risks above \$1 million were excluded.

If Citizens purchases reinsurance using their “best efforts” and is able to receive repayment under the reinsurance for future claims, then the likelihood of assessments to residential policyholders may be decreased.

### **Grounds for Disapproval of Policy Forms**

The broader authority for OIR to disapprove policy forms for property and casualty insurance for any provision that is unfair, inequitable, etc., may provide greater protection and greater benefits to policyholders, but it may be at a higher premium.

### **Mediation Program for Resolving Property Insurance Disputes**

Commercial residential insurers may experience increased costs due to payment of mediation costs due to the bill’s allowance for commercial residential insurers to participate in the property mediation program.

#### **D. FISCAL COMMENTS:**

State Government Impact:

Office of Insurance Regulation

There may be increased costs to OIR due to the requirement to hold a public hearing on residential rate filings exceeding 15 percent, however, the Office has not provided an impact statement.

Office of the Auditor General

The Office of the Auditor General has estimated that it will cost \$75,000 to conduct the operational audit of Citizens. The Auditor General would engage a specialist related to claims adjusting and processing.

Department of Environmental Protection

In order for DEP's Division of Resource Assessment and Management/Florida Geological Survey (DRAM/FGS) to manage and maintain a “sinkhole database” as required by the bill, a level of professional review and management must be maintained in order to ensure the viability of the product. The management and oversight of the database would need to be done by someone with Geographic Information Systems (GIS) expertise, and in order to coordinate the preparation of map presentations and interpretative reports with GIS staff would likely require the services of a professional geologist. This can be accomplished in two ways, either by outsourcing the tasks or through FTEs. While exact figures are unknown, it is estimated that the costs would be approximately \$150,000 annually. The department can absorb various administrative, computer network, peer field and office support for either option in order to carry out this function. In addition, a departmental management team could oversee and coordinate assignments with the Department of Financial Services (DFS) as requested. The department's DRAM/FGS research library, lab facilities, and geology sample library will also be an available resource.<sup>27</sup>

## **III. COMMENTS**

### **A. CONSTITUTIONAL ISSUES:**

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<sup>27</sup> Information provided by Department of Environmental Protection in response to a request for fiscal impact on DEP relating to sinkhole investigations and maintaining a sinkhole database addressed in HB 1937. Information received April 8, 2005, by electronic transmission from Bruce Deterding.

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to take an action requiring the expenditure of funds, does not reduce the authority that counties or municipalities have to raise revenue in the aggregate, and does not reduce the percentage of state tax shared with counties or municipalities.

2. Other:  
None.

B. RULE-MAKING AUTHORITY:

Regarding establishing rates for Citizens, the Financial Services Commission is authorized to adopt rules establishing criteria for determining whether a reasonable degree of competition exists for personal lines residential policies.

Regarding the sinkhole database, DFS, in conjunction with DEP, is authorized to adopt rules to implement the bill's provisions relating to the sinkhole database.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

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

On March 31, 2005, the Insurance Committee adopted four amendments to the bill and reported the bill favorably. The amendments adopted amended the text of the bill as follows:

- Deleted the section of the bill creating a timeframe for insurers to pay property insurance claims and requiring insurers to abide by the timeframe.
- Added a requirement for Citizens to pay per policy bonuses to insurers who take policyholders out of Citizens for at least 3 years ("take out bonuses") and provides a specified per policy bonus amount that is a percentage of written premium (12.5%, 15%, or 17.5%) based on the number of policies the insurer takes out of Citizens (10,000 minimum; 30,000 minimum or 50,000 minimum).
- Corrected a cross-reference and removed an erroneous deletion to correct technical problems with the bill.

The staff analysis was updated to reflect the four amendments adopted in the Insurance Committee.

On April 11, 2005, the State Administration Appropriations Committee adopted one amendment to the bill and reported the bill favorably. The amendment deleted the section of the bill relating to provisions of the legislative intent of the valued policy law.