FRAMING FLORIDA'S LOOMING
Property Insurance Crisis

THE FLORIDA COUNCIL OF 100

FLORIDA CHAMBER of Commerce

INSIDE COVER

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No one knows what will happen when the next big storm strikes Florida shores. But the signs are not promising....Millions of Floridians now bet their homes on property insurers that teeter on the edge of financial failure.

Sarasota Herald-Tribune, February 28, 2010

"It is difficult to accept that Citizens, 40 new companies, and what is likely to be a remnant of national companies comprise an adequate homeowners insurance program" in Florida. In other words, we're still in a mess.

Tampa Tribune, June 26, 2009

Who needs Mother Nature to cause a catastrophe? Florida's politicians are busy creating an unnatural disaster in their state insurance market that will blow away taxpayers when the next big hurricane hits.

Wall Street Journal, February 4, 2009

One simple fact ought to dominate every discussion of Florida's homeowners' insurance system: Were a single storm to hit the wrong area, it would literally bankrupt the state.

Journal of the James Madison Institute, Summer 2008

Florida took this notion of spreading this risk and turned it on its head.

New York Times, August 26, 2007

The Situation

We escaped the 2009 hurricane season, but Florida is still one storm away from severe financial risk. Consider, in a state with more than $2.1 trillion in property exposure…

- State-run Citizens Property Insurance Corporation (CPIC) has become Florida's largest residential property insurer — an insurer that is more than $9 billion undercapitalized and which charges its 1 million policyholders **rates that are not actuarially sound**.
- The Florida Hurricane Catastrophe Fund (CAT Fund) faces a $4.2 billion shortfall should it have to make good on its promise to pay hurricane claims.
- Key financial rating agencies are watching Florida, looking to downgrade the ratings of insurance companies, as they recently have with State Farm and Allstate affiliates. As that happens, millions of homeowners may have insurance policies that do not qualify for their mortgages to be sold.
- Already owing nearly $5 billion to be repaid in hidden taxes, or insurance assessments, since 2005, Floridians might have to pay average annual hidden taxes of $1,440 or more for several years if a major storm or series of storms hit.
- Despite a 15% rate increase, State Farm, Florida's largest private property insurer, has announced that it still must shed 125,000 of its 810,000 residential insurance policies statewide, just to stem its financial deterioration, and Florida's Office of Insurance Regulation has acknowledged that there aren't enough other private companies in Florida to appropriately fill the void. Additionally, Nationwide Insurance said in October that it is dropping 60,000 homeowners policies.

While the 2009 Legislature passed two measures in an attempt to address these problems, there is still much work to be done. House Bill 1495 (2009), which Governor Crist signed into law, will eventually reduce the CAT Fund's exposure and increase CPIC's rates to actuarially sound levels. Those changes will be phased-in over several years, leaving the state vulnerable in the interim while continuing to provide deeply discounted insurance to millions of property owners and shifting tens of billions of dollars of risk from a market-based private sector to taxpayers.[1]

Furthermore, while not a panacea, the vetoed House Bill 1171 would have enabled Floridians to pay a higher than regulatory-approved property insurance rate for coverage with the insurer of their choice and the comfort of knowing that they could rely on a well-capitalized company to pay their claims in the event of a damaging storm. It is widely believed that such "consumer choice" legislation would have made Florida's property insurance market more attractive to key large insurers like State Farm.

The bottom line — one major hurricane hit and Florida would still likely have to turn to the Federal government for assistance or face severe financial crisis.

The Goal

To relieve the taxpayers of the State of Florida of the potential burden of hidden taxation, over a period of many years, as the result of insurance assessments stemming from the assumption of unreasonable financial exposure to hurricane catastrophe losses.

1 In fact, a combination of market forces and the provisions of House Bill 1495 have already reduced the potential CAT Fund shortfall from $18.5 billion at the beginning of 2009 to $4.2 billion in November 2009. More specifically, the enactment of HB 1495 has resulted in a transfer back to the private market of $6.4 billion in residential property insurance losses in the event of a large storm. There is currently a 5.3% probability of a storm big enough to exhaust the CAT Fund's estimated claims-paying capacity. Meanwhile, as a result of HB 1495 eliminating the CPIC rate freeze and allowing CPIC's rates to increase by 10% until they are actuarially sound, CPIC's average homeowners insurance rates are to increase by more than 5% in 2010. This reflects both double-digit rate increases and decreases, depending on the actuarial soundness of an individual property's rates.

The Answers

While the following principles aren't necessarily the only answers, they do establish some policy stakes for future work in this area.

- **Let risk determine rates**, whether its government or the private sector running the show. Having low-risk policyholders subsidize high-risk policyholders is neither equitable nor economically sound; it doesn't change high-risk behavior. We must establish actuarially sound rates and effectively price risks such as geographical location, age of structure, construction, etc. for underwriting risk acceptance.
- **Promote competition**. The state must do what it can to bring competitive insurers to the state. Risk-based rates would go a long way to achieving this, and competition among insurance companies should eventually help decrease those rates.
- **Incent mitigation.** The best way to deal with hurricane loss is to prevent it. Existing structures can be retrofitted, and the building code can be strengthened. Yes, construction costs might go up, but they should be mitigated by insurance discounts up-front and less damage on the back-end. Mitigation credits should not be used to artificially reduce rates.
- **Ensure fairness.** Insurance companies have the responsibility to fully and clearly explain policy parameters up-front to policyholders and settle claims quickly, fairly, and fully based upon those parameters. Likewise, policyholders have the responsibility to ask only for discounts for which they truly qualify and file claims only for damage that actually occurred to covered property due to covered events.
- **Optimize public-private partnership.** Given the unique nature of the property insurance risks facing Florida, meeting the state's insurance needs requires the involvement of both the public and private sectors. The key is to find the most appropriate and most effective balance between the two, which optimally promotes the other principles described above. Nowhere is this more critical than at the federal level where, in many areas, Florida doesn't get its fair share of appropriated dollars. In fact, the idea of using federal loans or a line of credit to provide needed liquidity after a catastrophic storm is a balanced mix of public and market policy.

The Plan

Risk-based rates: House Bill 1495 (2009) set the Citizens Property Insurance Corporation (CPIC) on a glide path to actuarially sound rates. However, the 4-5 year implementation timeframe was politically, rather than mathematically, driven and should be both expedited and amended to account for the small percentage of policyholders who actuarially are paying too much. As quickly as possible, CPIC must return to serving its original intent as the state's "insurer of last resort," and, even then, consider certain classes of risks (e.g., geographic location, construction) ineligible from future underwriting acceptance.

Furthermore, the private property insurance market must be allowed to charge risk-based rates – especially if policyholders are asking to pay such rates as an alternative to joining CPIC. The vetoed House Bill 1171 (2009) was one such vehicle for moving in that direction. And while overall market balance and competitiveness must be preserved, it is evident that Florida's largest and best-capitalized insurers need to be able to charge actuarially sound rates to survive. Otherwise, the gaping hole left by State Farm and Nationwide will grow bigger and bigger – putting us all at more risk.

Mitigation: The flip-side to dealing with storm damage is preventing such damage, or mitigation. It has been estimated that, for every dollar spent in storm preparation, $4 to $7 is saved in reconstruction costs. A tough budget year, however, forced the state's main mitigation program, My Safe Florida Home, to lapse at the end of June 2009. The 2006 program had helped more than 430,000 Floridians have their homes inspected or retrofitted for hurricane safety, resulting in both reduced insurance rates and new jobs. Whether it's through My Safe Florida Home or another prevention program, the state must renew its financial commitment to mitigation as soon as possible.

Good faith: Just as insurers must pay valid claims as quickly as possible, policyholders must be truthful in their dealings, too. Mitigation discounts should only be sought and granted when risks are actually reduced. Additionally, the state should move to prevent invalid claims arising from old damage and/or abuse of the "replacement cost" law (s. 627.7011, F.S.) and the "matching" law (s. 626.9744, F.S.).[2] Finally, to stem the tide of frivolous first- and third-party bad faith lawsuits against insurance companies, s. 624.155, F.S., should be amended to allow insurers to correct inadvertent mistakes before being slapped with a suit.

Federal participation: We need to have a federal backstop for a Florida catastrophe. In fact, steps are already being taken to do just that.

U.S. Sen. Bill Nelson and U.S. Rep. Ron Klein have filed bills that would create a national catastrophe consortium to help states spread their risk from natural disasters such as hurricanes, tornados, and earthquakes. By pooling their risk, the roughly 30 state-sponsored catastrophe funds could sell bonds or buy reinsurance to cover potential future losses. The bills would also provide a federal guarantee for any debt states would have to issue to help pay for disaster losses and would establish a federal mitigation grant program to incentivize the hardening of homes.

Passage of any national legislation that might serve as a backstop for Florida's potential catastrophic losses due to a natural disaster still faces a very steep uphill battle from states that argue Florida's extreme exposure to natural disasters would pose an unfair burden to U.S. taxpayers. But Nelson, Klein, and other Florida Congressional leaders are encouraged by support expressed by President Obama who has said he is in support of some federal backstop for Florida and other states that are at higher risks for hurricanes, earthquakes, and other natural disasters. Moreover, representatives of 33 states are now co-sponsoring Rep. Klein's bill.

Numerous Studies and Recommendations

Numerous experts have considered, studied, and opined on the subject of Florida's property insurance market. In examining the multitude of recommendations emerging from such stakeholders and analysts over the past few years, some themes shine through.

See Appendix A for a summary of Select Florida Property Insurance Reform Recommendations Since 2006.

2 The "replacement cost" law requires homeowners claims with replacement cost coverage to be paid on a replacement cost basis at the time of the loss. Before 2006, the claim was paid at actual cash value until repairs were completed and the actual repair/replacement cost of the loss was no longer an estimate. The "matching" (or "chipped tile") law requires homeowners policies to pay for repairs or replacement of items in adjoining areas if the damaged items can't be matched.

APPENDIX A

Select Florida Property Insurance Reform Recommendations Since 2006 *(in chronological order)*

Governor's Property Casualty Insurance Reform Committee, November 2006

- Maximize and leverage the use of the Florida Hurricane Catastrophe Fund (CAT Fund), the state's reinsurance entity, during this current cycle of astronomically high private market reinsurance rates. Recent reinsurance market rates caused significant negative premium impact to consumers via the cost of reinsurance on direct writers. The Committee recommends authorization of a lower level of CAT Fund coverage below the $5.3 billion attachment point for a limited duration of perhaps two storm seasons on a voluntary participation basis. The Legislature should consider a similar short-term market enhancement on the top end of the CAT Fund above the $15 billion cap and investigate allowing commercial non-residential property insurers to access some level of CAT Fund coverage. The Committee recommends charging a "near market rate" premium for this coverage.
- Create enhanced insurance policy transparency to inform consumers of residential and commercial policies of the details of their premium charges. The premium notice and policy should include the specific dollar amount of potential premium mitigation discounts available and itemized by mitigation measure; assessments from authorized entities such as Citizens Property Insurance Corporation (Citizens), the CAT Fund, and the Florida Insurance Guaranty Association (FIGA); rate increase premium impacts and agent's commissions; and specific premium tax amounts. This transparency must be in plain language and easy for consumers to understand.
- Require insurers to offer policy options such as ex-wind (covering all perils other than property losses caused by wind), wind only (excluding personal contents coverage), lower dwelling limits options, and unlimited deductible options.
- Move the Office of Insurance Consumer Advocate to report directly to the Governor and Cabinet (Financial Services Commission) and strengthen its independence.
- Enhance building codes — Elimination of the Panhandle exemption prohibits any change in future statewide building codes unless the change enhances the structural integrity of the code as it relates to wind protection. Require a uniform statewide building code that requires American Society of Civil Engineering (ASCE) wind lines. The Committee also encourages local governments to consider providing incentives for building to a code plus standard for new construction.
- Enhance mitigation — Consider maintaining and expanding the Mitigation Program created during the 2006 Session. Full implementation of residential mitigation measures has the potential to reduce Florida's loss exposure by more than 60 percent. The Committee learned that every dollar spent on mitigation translates to an average of four dollars in savings. Encourage Citizens policyholders to upgrade and retrofit their structures through mitigation techniques. Earmark a portion of mitigation funding for Citizens policyholders to reduce the risk of greater exposure to back-end assessments on all Floridians. Require modeling firms used by insurers in their rate filings to recalibrate their models to take into account the results of mitigation.
- Eliminate the lengthy and costly process of Citizens seeking rate increases with the Office of Insurance Regulation (OIR). Require OIR to set Citizens' rates regularly, based on the highest approved rates in the voluntary market.
- Eliminate the state's antiquated windstorm boundaries to allow Citizens to write a complete policy throughout the state.

- Enact insurer incentives to encourage Citizens take-out plans.
- Evaluate market incentives to bring additional capital formation and insurer opportunities to Florida. Extend and modify the Insurance Capital Build-up Incentive Program to allow more flexibility for insurance companies to access the capital. Encourage new capital market risk transfer vehicles and promote the State Board of Administration's use of financing techniques such as catastrophe bonds, sidecars, and other capital market alternatives. Continue and promote Florida's review of state participation in an insurance exchange for its catastrophe risk transfer products and evaluate changes to Florida's captive insurer law. Seek viable methods to create tax-free catastrophe reserve accounts.
- Merge the Property Casualty Joint Underwriting Association's commercial policy underwriting process with Citizens' commercial policy issuance to streamline the two entities duplicative state action.

Former Florida Rep. Dennis Ross, Summer 2007

- Principle of a Healthy Insurance Market — Insurance is a necessary product in the mix of our economy. It is vital for a growing economy and is critical to economic vitality. Without insurance, transactions such as the buying and selling of homes and automobiles would be significantly limited. Insurance is the oil with which our system of commerce continues to be lubricated. Insurance is a commodity, not unlike groceries, fuel and other products. There is only so much insurance, and it too is susceptible to the laws of supply and demand. When demand is high, supply is low, and prices are then high. With Citizens and the CAT Fund, the State of Florida is not selling insurance, because it has none. Rather, it is selling debt, backed by assessments to Florida's taxpayers.
- Principle of a Healthy Insurance Market — Insurance must be backed by private capital, not taxpayer debt financing. As a result of the 2004-2005 storm seasons, private insurance companies paid out $39 billion to rebuild Florida. Now, if we encounter another storm cycle reminiscent of 2004 and 2005, it is our consumers and taxpayers who are left to pay these claims. The thought of a repeat of those two years, with the State of Florida paying the bill for that risk, is frightening. The total debt of the state is $22 billion. This debt accumulated during the course of Florida's more than 100-year history as a state and could, literally, double overnight with one storm. With this increase in debt, the State's overall bond rating could suffer, thereby increasing its borrowing costs and exacerbating an already tenuous financial situation.
- Principle of a Healthy Insurance Market — The risk of living in high-risk areas should be borne by people who choose to live in those areas. To allow the state to continue to subsidize insurance for those who choose to live in high-risk areas does nothing to change the undesirable behavior of building in these areas, and those who choose to live in lower risk areas continue to subsidize the cost of their coverage.
- Principle of a Healthy Insurance Market — The State of Florida must strictly enforce building codes, and should promote and invest in an aggressive retrofitting of existing structures. We know that Florida will most likely be in the path of at least one hurricane each year. We also know how to build new structures and retrofit existing structures to withstand these storms.

Former House Committee on Insurance, Don Brown (Chair), April 2, 2008

- Rewrite the Citizens rate freeze to allow a modernized rating plan and actuarially sound rates to be filed as soon as possible and effective in 2009, while protecting consumers by phasing in any rate increases for existing individual policies from current levels at a reasonable pace. This will signal consumers to make responsible insurance choices and put Citizens on the path to funding its obligations while easing the transition effects on consumer and business budgets.

- Revisit Citizens' charter as a true residual market entity. Property owners offered private insurance at approved rates should be ineligible for Citizens, especially for commercial policies such as coastal builders' risks. This will ensure Citizens is a safety net and not a subsidized alternative to willing, regulated providers.
- Specify that actuarially sound rates for Citizens include a provision for pre-funding of its obligations via reinsurance. Such funding should cover the same loss scenarios as required by the Office of Insurance Regulation (OIR) of all private market insurers: the "1-in-100 year" probable maximum loss. It has been recently reported that only the High Risk Account would see significant rate increases as a result, and consumers now have a choice to buy a multi-peril Citizens policy to forestall that effect, anyway. Finally, with the provisions above, any rate increase would be phased in over time.
- Increase the transparency of regulatory activities by requiring OIR to maintain a public, web-accessible database of overall rate level requests filed, the amount recommended by OIR actuaries, and the amount approved by the Commissioner. Given that private actuaries must swear under penalty of perjury that their indications are fair, not misleading and reflect all legislative enactments, require a similar statement from OIR actuaries with respect to their published recommendations. In the public filing documentation, require OIR actuaries to disclose their major assumptions, and whether those deviate from the professional standards of the American Academy of Actuaries. Additionally, when any proposed action on a rate filing is reviewed by OIR, require those meetings to be open to the affected parties (including the public) and in the sunshine.
- Increase the efficiency of rate regulation by restoring a provision allowing expedited approval of rates and rating plan adjustments not exceeding a certain level, but with new consumer safeguards: a phase-in of individual policy premium increases exceeding an annual limit, and a requirement that annual filings be up-to-date before and after the expedited adjustment for a period of one year. This would speed competitive rates to market, free OIR to focus on significant pricing and coverage issues, and force insurers to continuously maintain fair rates.
- Allow the temporary prohibition on "use and file" rate filings, whereby rates are changed and full filings made within 30 days, to sunset. This will let insurers respond to changing market conditions – including offering competitive rate decreases – in the future, as well as lessening the regulatory burden on OIR. This would not prevent Citizens takeouts from still being regulated to allow depopulations only at approved rates.
- If the temporary prohibition on property rate arbitrations is not allowed to sunset, then replace it with provisions installing an expedited judiciary process at the Division of Administrative Hearings (DOAH) so that insurers and OIR may have fast, final decisions on rate and rule disputes.
- Allow the unfettered use of information from hurricane risk models accepted by the Commission as actuarial support for rate filings. Rates are already regulated, and filing actuaries are already bound by law and standards regarding supporting information. However, OIR continues to stonewall the use of accepted models by insisting on the ability to disclose proprietary documentation already reviewed by the Commission under a process which assures public accountability while protecting trade secrets.
- Allow insurers direct access to the Public Hurricane Model and its detailed loss results prior to OIR's decisions based on those results.
- Prohibit OIR from mandating territorial rate caps which force low risk homeowners to subsidize the insurance costs of high risk homeowners.
- Increase consumer awareness of the potential for "hurricane taxes" or assessments by requiring Citizens and the CAT Fund to annually calculate and publish an estimated percentage assessment, levied over a defined period, for a 1-in-100 year storm that strikes in the upcoming season. Require all insurance policy declarations pages to contain a notice specifying this estimated annual assessment in dollars and the period over which it would be levied.

- Continue to encourage responsible and affordable wind mitigation by funding the My Safe Florida Home Program and requiring wind loss mitigation rating plans for insurers. Allow insurers to develop these plans using the results of any and all hurricane models accepted by the Commission, but including discounts for all features enumerated in the current rule.
- Develop a long-term growth management plan for the State of Florida that does not encourage inappropriate development by forcing Floridians to provide below market insurance coverage for coastal development.

Raymond James & Associates, January 30, 2009

- Reduce CAT Fund funding gap (OPTION) — Reduce the size of the CAT Fund's potential obligations; this is a legislative solution, which would address the funding gap not by increasing the CAT Fund's resources but rather by decreasing the amount of its potential claims payments. This would require legislative action, and the timing may leave private markets unable to fill capacity in the short-term.
- Reduce CAT Fund funding gap (OPTION) — Purchase funding shortfall products in private markets; this would involve using private markets - either bank markets (not currently viable), capital markets (not currently viable), reinsurance markets, or some combination thereof - to put in place financial mechanisms designed to close or reduce the funding gap. In general, private market options will be difficult and expensive to put in place this year, but there may be viable products that can be put into place.
- Reduce CAT Fund funding gap (OPTION) — As a potential alternative to private funding, the CAT Fund may also seek governmental help in closing the funding gap. This could potentially come in the form of state or federal assistance via a formal liquidity program or debt guarantee. With state assistance unlikely; federal liquidity or guarantee could provide the best solution. In any event, the CAT Fund should consider pursuing this solution along side any other efforts.

Citizens Property Insurance Corporation Mission Review Task Force, January 30, 2009

- Create programs to encourage the strengthening of homes.
- Amend current law so as to provide that, upon expiration of the Citizens rate freeze, a "glide-path" to implement rate increases over time should be implemented, with specified increases per year, excluding coverage changes and surcharges, as follows: limit the overall average statewide increase by line to no more than 10% per year; limit the rate increase by territory by line to no more than 15% per year; and limit the rate increase for any individual policyholder to no more than 20% per year.
- Amend current law to enforce the 15% Eligibility Rule by requiring that agents and applicants for coverage certify, as a part of the application process, that they are eligible for coverage under the law.
- Require that agents and policyholders affirm each year, as a condition of renewal, that they are still eligible for coverage with Citizens. This recommendation will require agents and policyholders to shop for coverage each year.
- Enact a statute to require that Citizens obtain a new application from all policyholders who have had a policy in-force with Citizens for more than three years.
- Enact a statute to limit automatic renewals for Citizens business to two, thereby requiring policyholders to reapply for coverage every three years.
- Enact a statute to provide for the adoption of fines or other penalties (such as losing eligibility) for applicants that violate Citizens eligibility standards or make false statements on Citizens applications.
- Eliminate the statutory language in Section 627.0655, F.S., that allows companies to offer multi-

policy discounts on automobile business when the same agent places a homeowners' policy with Citizens. This change would not prohibit companies from offering multi-policy discounts that were actuarially justified.

- Repeal Section 631.65, F.S., which prohibits agents from discussing the existence of the Florida Insurance Guaranty Association.
- Enact a statute to provide that, effective as of a specified date, no new structure erected seaward of the 30-year erosion projection line or in Coastal Barrier Resources System designated areas is eligible for coverage with Citizens.
- Readdress the boundaries of the High-Risk Account in an effort to make them more geographically consistent, with the goal of reducing Citizens' wind exposure.
- Repeal the language in Section 627.351(6), F.S., which requires Citizens to write commercial non-residential wind-only and commercial non-residential multi-peril coverage.
- Require that a study be conducted to determine what actions could be taken to move more of Citizens commercial residential business to the private market.
- Amend current law to require that agents demonstrate annually an appointment with at least one property insurer that is actively writing and not engaged in massive non-renewals.
- Improve the quality and quantity of policy level data made available to takeout companies to encourage additional depopulation.
- Expand the Florida Market Assistance Plan to require that 100% of Citizens policy data, within applicable privacy laws, be made available as many as 120 days before a policy is set to renew.
- Adopt fines or other penalties (such as losing appointment with Citizens) for agents that violate Citizens eligibility standards or make false statements on Citizens applications.

Florida Hurricane Coalition (floridahurricanecoalition.org), February 17, 2009

- Transform the CAT Fund, a tax exempt agency of the state, into the exclusive insurer of residential hurricane risk in the state of Florida. This transformed fund, nominally called the Hurricane Fund (HF), would charge a premium adequate to cover the average annual loss (AAL) from hurricanes, the cost of administration including reasonable commissions to primary insurers for their services, and a surcharge to build up surplus in low loss years and to service debt incurred for above average claims payments in catastrophic loss years. Implementation of this plan is dependent upon the enactment of a federal catastrophe loan program to provide non-subsidized loans to the HF. HF determined rates for hurricane risk would be incorporated into the all risk rates offered by primary insurers who would issue policies, collect premiums and deal directly with their customers, or through their agents, as before.

Eli Lehrer, Senior Fellow of the Competitive Enterprise Institute and an Adjunct Scholar of The James Madison Institute, March 2009

- Getting Florida's property insurance system to work will require sweeping, drastic action. In the long term, the free market provides the best solutions to Florida's system: if insurance prices are allowed to reflect the risks that property owners actually take, then new insurance companies will enter the state in large numbers and sell insurance to anyone willing to pay the prices they charge. In theory, simply abolishing Citizens, the Catastrophe Fund, and all rate regulation of insurance would solve Florida's insurance crisis entirely.
- The political challenges of eliminating rate regulation, however, appear daunting. Moving towards a free market for insurance will take significant work: wholesale elimination of Citizens or the Cat Fund and, indeed, even wholesale deregulation of rates, would have disruptive consequences for all Floridians. Thus, the state needs a gradual, incremental plan — a glide path — towards a better insurance environment. A strong plan would have four

major components: a phase out plan for Citizens, a similar plan for the Cat Fund, modest changes to the approval system intended to attract new out-of-state capital, and an effort to reduce property risk throughout Florida through a comprehensive, environmentally sensitive mitigation strategy.

- o Citizens: Implement Task Force Recommendations. . . But Go Further — A broad-based Citizens study task force convened in 2008 released its final report in early 2009. The task force came up with 17 recommendations that can be summarized in three major points:

  A "glide path" that will increase overall rates by 10 percent a year (placing 15 and 20 percent caps on increases for territories and individuals).

  Tighter enforcement of rules requiring Citizens to write policies only when private market policies are unavailable.

  A variety of new limitations on where and when Citizens can write policies.

  Although the 10-15-20 formula the task force arrived at makes some sense, it seems subject to political manipulation. Since the overall increase is capped, as more contained small areas get full 20 percent increases, rate increases will be smaller for the rest of the state. This appears subject to manipulation by powerful groups. It may make more sense to simply impose a 20 percent cap on individual increases — or some other overall cap — and let actual risk factors sort out the increases. Rather than such universal caps, the task force also may want to consider certain provisions to provide relief to people living on fixed incomes and receiving Citizens coverage. In fact, the Legislature might even mandate even greater increases — to full actuarial adequacy — for the state's most expensive houses. The wealthy should not continue to receive subsidies. The Legislature may want to consider measures that could mitigate the rate increases for low-income Floridians.

- o The Cat Fund: Eliminate the TICL Layer Immediately, Phase Down the Remainder of the Cat Fund — In the long term, the Cat Fund needs to go. To eliminate it, the Legislature should eliminate its most egregious feature — the so called "TICL layer" first — and then launch a plan to phase it down over time. In the short term, however, Florida might do best to target the least necessary and totally impossible-to-fund portion of the Cat Fund: the so-called "Temporary Increase in Coverage Layer." The Layer, essentially the last $12 billion of the $28 billion total authorized amount of the Cat Fund, has never been funded and in all probability could never be funded. Following the elimination of the TICL layer, the Legislature should authorize a long-term review of the Cat Fund based on yearly reductions that would take place until the Cat Fund is fully solvent. To recommend an exact course for these reductions, the Legislature might consider creating a commission to review the Cat Fund and setting a deadline — perhaps 2014 — for creating a Cat Fund able to survive without a significant need to impose special taxes (assessments) on Floridians' insurance policies.

- o Private Market: Allow Flex Rating Within the Context of the Current System, Change Standards for Approval — Many Floridians feel that the state's current "prior approval" system for insurance rates helps to protect them and keep rates down. And they may well be right — in the short term, rates would go up if insurance regulators would allow it. Rather than eliminate prior approval in one fell swoop, the state should adopt a "flex rating" system that allows insurers some flexibility to change rates without unduly disrupting the insurance system Floridians have grown used to. Flex rating, which about 20 states have adopted in one form or another, allows insurers to make small adjustments in rates rather easily in response to changing market conditions. The current prior approval system would continue to exist alongside a system of flex rating: rates outside of a band of, perhaps, plus or minus ten percent per year, would undergo the same review process as now exists. If the Office of Insurance Regulation found a flex-rating filed rate either unfairly discriminatory or likely to damage an insurers' solvency, likewise, it could "claw back" the rate and order an insurer to either refund premiums or impose special assessments on its own policyholders. With the flex-rating bands, insurers could raise and lower rates as market forces dictated. Although the simple ability to raise rates 10 percent — by itself — would not encourage many insurers to enter the state, it would likely result in some insurers that currently do not write new coastal business to write at least some.

- My Safe Florida Home and Wetlands Preservation — Long-term improvement in Florida's insurance environment will require steps that actually reduce Florida's risks. Risks will be reduced the most, in the medium and long terms, when insurers can charge risk-based rates. If insurance rates reflect risks — which can be extreme in large parts of coastal Florida — residents will avoid building in dangerous areas and reinforce those properties already built there. However, an immediate switch to risk-based rates would cause enormous dislocations in Florida's property insurance markets and leave many people unable to afford property insurance. Two short-term policies, therefore, deserve consideration: full funding for the My Safe Florida Home Program and efforts to preserve and protect coastal wetlands. My Safe Florida Home, which provides for no-cost home inspections for Floridians and helps residents of modest means reinforce their homes against storms, seems to work. The Legislature may wish to consider efforts that would give the program a dedicated funding stream, such as placing special taxes on premiums paid to Florida-only companies that fail to secure non Cat-Fund coverage. In addition, Florida should consider increased efforts to preserve and protect the state's wetlands. Current federal policies under the Coastal Barrier Resources Act (CBRA) severely restrict all federal subsidies for development in sensitive coastal areas. Citizens, nonetheless, writes some policies in areas where CBRA restricts federal funding. Florida should consider its own version of CBRA, restricting all state funding for development in sensitive coastal wetland areas. The Legislature may also consider efforts to require "like kind and quality" replacement of whatever wetlands get lost to development. The current policy, it might be argued, puts wildlife habitat ahead of human interests. A "like kind and quality" policy might actually allow small net losses of wetlands in some cases — particularly when it comes to inland wetlands that provide wildlife habitat alone — but would work to increase the amount of coastal wetlands and thus Florida's protection against storms.

Shield Our State Coalition (shieldourstate.org), March 8, 2009

- Transform the CAT Fund into a publicly owned and funded "Hurricane Insurance Pool" (HIP). The HIP would become the sole provider of hurricane insurance for all residential, commercial residential, and small business properties in the state. Primary insurers would issue property policies, with all hurricane risk being ceded to the HIP. The HIP would set a statewide premium of the amount needed to pay losses up to a 1-in-100 year hurricane, plus payment for reinsurance of the risk beyond, up to a 1-in-250 year hurricane. The premium would then be allocated across all properties in the state, such that each property bears its fair share of the risk based on location and type of construction. Each property's hurricane premium would be collected by the primary insurer and passed through to the HIP, leaving the carriers to underwrite and manage the balance of normal wind and other risks.
- The federal government would provide matching low-interest loans for post-event financing, through redirecting funds presently available in existing programs. The present SBA system provides low-interest loans directly to property owners, as mortgages on their properties, over and above any funds received through insurance coverage. This concept merely redirects the loan dollars to the HIP, which will provide sufficient funding for all property owners to rebuild from 100% insurance coverage proceeds, with repayment to the federal government being made directly from the HIP premium revenue stream, already funded by the property owners. The current federal programs provide for a sharing of costs between an affected state at 25% and the federal government at 75%. This program would split the responsibility 50/50 between the federal and state governments, with all funding being guaranteed through premium revenues.

- HIP premiums will be calculated based upon type, location and construction of insured properties, thus spreading risk and losses equitably across all properties. Premiums for hurricane policies will be set on a long-term claims exposure basis, which will utilize accumulated premium reserves to preserve capital to meet a large predictable expense (i.e. hurricane losses) projected to occur within an extended time period (i.e. 20 years), the unpredictable element being the timing of the occurrences.
- Financing will be accomplished by pledging the current surpluses of the CAT Fund and Citizens (currently estimated at $5 billion), plus annual recurring premium retention (calculated at $5 billion) to fund both pre-event capitalization of $20 billion (more than the expected losses from a 1 in 20-year hurricane season), and post-event financing of an additional $20 billion ($50 billion being the expected losses from a 1 in 100-year hurricane season).
- HIP debt would be serviced solely from premiums and premium adjustments, without resorting to assessments and/or taxation of property and non-property policyholders, or further impacting state financial resources and credit ratings.

James W. Newman, Jr., Florida Catastrophic Storm Risk Management Center, July 2009

- While rolling back and freezing Citizens' rates and the Florida Hurricane Catastrophe Fund's use of "below market" rates produce lower property insurance rates in the short run, the longer term effects of these actions appear to have various adverse effects, including, but not limited to, reduced financial resources for Citizens and the FHCF to pay catastrophic hurricane losses and the likelihood of much larger deficits in Citizens and the FHCF that could cause unacceptably large deficit assessments on virtually all Florida residents over many years.
- The Florida Legislature may not have intended the deficit assessment processes set forth in Florida Statutes for Citizens, FHCF and FIGA to produce sizeable subsidies from policyholders in some parts of the state to residential property insurance policyholders in parts of the state with higher hurricane exposure; however, this is the result of the current statutory assessment procedures.
- The implicit nature of Florida's assessment-related subsidies appears capable of producing a wide range of negative effects typically associated with many government subsidy programs, i. e., subsidy leakage, subsidies across time, unintended consequences, and negative externalities.
- While this report has referred primarily to inter-county assessment-related subsidy issues, there are similarly important intra-county assessment-related issues in coastal counties.
- Legislative action to substantially reduce the assessment-related subsidies described in this report would seem to have several benefits. In addition to reducing the negative effects of the subsidies and enhancing the financial capacity of Citizens and the FHCF to pay hurricane losses, it may also facilitate the development of greater hurricane loss mitigation incentives and the achievement of greater hurricane loss mitigation activity in both new and existing residential properties.

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INTO THE STORM

FRAMING FLORIDA'S LOOMING PROPERTY INSURANCE CRISIS

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