

Issue Brief

The 2006 Florida Legislative Session: Winners and Losers in the Property Insurance Debate

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Introduction

In any political battle, there are always winners and losers, and the recently concluded Florida legislative session proved to be no exception to that old adage.

By far the biggest issue that Florida's 160 lawmakers confronted during their 60-day session was how to get their collective arms around the latest problems with the state's property insurance market. And those problems must have seemed insurmountable to some lawmakers when they first convened in Tallahassee on March 7. Consider the following:

- The eight major hurricanes that struck Florida over the span of 15 months in 2004 and 2005 left the Citizens Property Insurance Corporation, the state's insurer of last resort, with a \$1.7 billion deficit;
- The Florida Hurricane Catastrophe Fund, the state's reinsurance mechanism, was facing the prospect of entering its 2006 contract year in June with a zero balance or small deficit after incurring losses in excess of \$6.8 billion in 2004 and 2005, and
- Florida homeowners were facing another assessment for 2005 storm losses on top of the one they already incurred for the 2004 storms.

By the time the final legislative vote was cast an hour before adjournment on May 5, it had become evident that lawmakers had made some significant progress in addressing the state's current property insurance problems. It was also true that "winners" and "losers" emerged among the various stakeholders involved in this issue.

This *Issue Brief* examines Senate Bill 1980, the comprehensive property insurance bill enacted by lawmakers, and assesses how well each set of stakeholders, including the lawmakers themselves, fared with the provisions in the bill.

Citizens Property Insurance Corporation

Perhaps the biggest “win” for Citizens in Senate Bill 1980 was the provision appropriating \$715 million in state general revenue funds to the company to help offset its 2005 budget deficit.

While the company’s top management no doubt viewed this cash infusion positively, the appropriation actually is smaller than what was first contemplated in the bills that made their way through various House and Senate committees in late April.

The House bill (HB 7225), for example, proposed setting aside \$920 million toward Citizens’ deficit, while the Senate bill called for a \$750 million appropriation.

It has been calculated that the \$715 million appropriation in SB 1980 will reduce Citizens’ premium assessment for 2005 from 11 percent to 2.5 percent. This is good news for Florida’s property owners.

Going forward, lawmakers also approved a new formula for handling future Citizens’ deficits. If a deficit occurs in any Citizens account, an assessment (up to 10 percent) will be levied on non-homestead properties, and those funds will be used to offset the deficit. If that assessment proves insufficient, the Citizens board will be allowed to levy an additional assessment up to 10 percent on all Citizens policyholders. That assessment will be collected when a policy is issued or renewed. Any remaining deficit will be covered through a statewide Citizens assessment under current procedures.

A persistent criticism of Citizens has been the fact that its rates do not adequately reflect its risks. In an effort to change that imbalance, lawmakers approved a new rating structure for Citizens that will be phased in over the next three years.

Beginning with policies issued on March 1, 2007, the rates for Citizens’ high-risk accounts (HRAs) will be based on a 70-year Probable Maximum Loss (PML). The PML will then be based on an 85-year event in 2008 and a 100-year event in 2009.

SB 1980 also requires that Citizens’ rates for its Personal Line and Commercial Line Accounts be sufficient in order to obtain reinsurance, including the Cat Fund, and to pay all claims resulting from a 100-year PML. This provision also takes effect on policies issued or renewed in March 2007.

Citizens also should accrue some relief on the types of risks it insures because of a provision in SB

1980 dealing with high-end properties. Beginning July 1, 2008, any personal lines residential structure or single condominium unit that has a combined dwelling and content replacement value of \$1 million or more will be no longer eligible for the HRA.

On the same date, non-homestead properties, regardless of their insured value, also will no longer be covered in HRA. However, owners of both types of properties will be allowed to reapply for Citizens coverage if they sign a sworn statement acknowledging that they have been declined by one admitted carrier and three surplus lines carriers.

In an apparent reaction to news earlier this year of an alleged contracting kickback scandal involving a top Citizens official, lawmakers decided to invest more authority in the Financial Services Commission (composed of Gov. Jeb Bush and the Cabinet) rather than the Office of Insurance Regulation (OIR) in overseeing the company’s plan of operation. Among the provisions approved by lawmakers is one calling for the executive director of Citizens to be confirmed by the Senate and applicants for any of the company’s senior management positions to be subject to background checks.

SB 1980 also requires competitive bidding and board approval on any contracts worth \$100,000 or more. The Citizens board and senior managers will now be subject to a code of ethics and to financial disclosure statements similar to those applying to public officials.

Board members and employees also will be prohibited from accepting any gift from any person or entity under contract to Citizens. The company is prohibited from retaining a lobbyist, but employees can register to lobby. Senior managers who leave Citizens will now be prohibited from representing any person or entity before the company for two years after their employment terminates.

In terms of additional oversight, Citizens will be required to have an internal auditor and be subject to an operational audit by the Auditor General every three years. OIR also will be required to perform a market conduct examination of Citizens every two years.

Lawmakers also addressed a number of operational issues. For example, Citizens will now be required to use public hurricane models as a minimum benchmark for determining its windstorm rates. The company will now be allowed to adopt policy forms that contain more restrictive coverage than provided

in the voluntary market. The OIR must approve or disapprove a HRA rate filing within 90 days.

Applicants for Citizens coverage will now be subject to a 10-day waiting period. If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application.

Citizens must now offer quarterly and semiannual premium payment plans. It also limits takeout bonuses to \$100 per policy.

Florida Hurricane Catastrophe Fund

SB 1980 requires a 25-percent, rapid-cash buildup factor in the premiums paid by insurers for coverage from the Florida Hurricane Catastrophe Fund (FHCF). This is a surcharge in addition to the premium calculated for insurers each year under a formula administered by the State Board of Administration (SBA).

The SBA Trustees (Gov. Bush, Chief Financial Officer Tom Gallagher and Attorney General Charles Crist) always have had the discretion to impose a rapid cash buildup surcharge, and did so for the first time last spring. It generated an additional \$200 million for a total Cat Fund premium of \$1 billion. SB 1980 now makes the surcharge mandatory as a way to expedite rebuilding the Cat Fund reserves and to reduce the amount of money the Fund would need to borrow through bonding.

Primary Property Insurers

From the perspective of the state's primary property insurers, Senate Bill 1980 probably represents a "mixed bag." Some provisions in the bill certainly can be viewed as "positive" while others clearly belong on the "negative" side of the ledger.

On the plus side, the final bill adopted a proposal from the original House bill that will allow insurers, beginning July 1, 2007, to increase or decrease rates by up to a 5-percent statewide average, or 10 percent for any territory, without approval by the OIR as long as the rate is not excessive or unfairly discriminatory. The rate may be used only once during a 12-month period.

The downside to this flex-band proposal is that the OIR must determine ahead of time whether a reasonable degree of competition exists for residential property insurance in order for the flex band to take effect.

The bill also requires OIR to approve a rating factor that provides an insurer a reasonable rate of return that is commensurate with the risk of covering hurricane losses for that portion of the rate for which the insurer has exposed its capital and surplus and has not purchased reinsurance.

Limited apportionment companies (companies with \$25 million in surplus or less) will now be allowed under SB 1980 to buy a \$10 million layer of coverage above retention of 30 percent of a company's surplus at a rate of 50 percent of the coverage selected.

SB 1980 also creates a \$250 million capital build-up incentive program for one year to provide funding in the form of "surplus notes" to new or existing residential property insurers under specified conditions.

By July 1, 2006, an insurer must apply to the State Board of Administration and agree to contribute new capital to its surplus at least equal to the surplus note. The amount of the surplus note may not exceed \$25 million or 20 percent of total funds available to the program.

The surplus note must be repayable to the state, with a 20-year term, at the 10-year Treasury Bond interest rate. The insurer must commit to meeting a 2:1 writing ratio of net written premium to surplus. The state would become a preferred creditor if the insurer became insolvent.

If an insurer applies for a surplus note after July 1, but before June 1, 2007, the note is limited to one-half of the new capital contributed by the insurer.

SB 1980 specifies that when an insurer makes a claims payment to a primary policyholder without an endorsement from a lien holder or mortgage holder, that payment must be made only for personal property and contents, additional living expenses or other covered items not subject to a security interest recorded in the dual interest provision of the insurance policy. The bill also strikes language allowing payment without an endorsement for the first 20 percent up to \$20,000 of property subject to a security interest under the policy's dual interest provision.

On the "negative" side, there's a provision in SB 1980 requiring ex-wind carriers on HRAs to adjust hurricane claims for Citizens beginning July 1, 2007. Industry lobbyists were able to delay implementation of this provision for a year, and will now have to work with the OIR on the development of the contracts.

The Florida Insurance Guaranty Association (FIGA) is authorized under the bill to impose annual emergency assessments on insurers of up to 2 percent of written premium for specified lines of property and casualty insurance to fund county or municipal revenue bonds to pay claims of an insurer that becomes insolvent as the result of a hurricane.

The bill also increases FIGA's maximum liability for a covered homeowner's insurance claim from \$300,000 to \$500,000; provides that FIGA cover business claims of businesses that have their principal place of business in the state as opposed to simply being incorporated in the state; and allows FIGA to pay claims of unearned premium refunds, under certain conditions, without requiring a proof of claim form.

Property Owners

Aside from the reduction in the Citizens assessment described earlier, Florida property owners were "winners" in SB 1980 in that some will now be able to take advantage of a three-year, \$250 million Florida Comprehensive Hurricane Damage Mitigation Program to be administered by the Department of Financial Services. However, funding for this program is considerably less than the \$392.4 million that House members initially earmarked in their version of the bill.

The new program will provide for free inspections of site-built, residential properties to determine what mitigation measures are needed to reduce vulnerability of hurricane damage. The home inspections will include a rating scale specifying the current and projected wind-resistance rating, and insurer-specific information on insurance credits and discounts.

Owners of properties with an insured value of \$500,000 or less will be able to receive 50 percent matching grants up to \$5,000 under the program while low-income homeowners will be eligible for 100 percent matching grants of \$5,000.

The bill also earmarks \$7.5 million for a Manufactured Housing and Mobile Home Mitigation and Enhancement Program administered by Tallahassee Community College. It will provide grants for manufactured-home communities and mobile-home parks.

Property owners also will be able to take advantage of a "sales tax holiday" on certain disaster preparedness items purchased between May 21 and June 1, 2006. This tax holiday in House Bill 47 applies to such items as portable generators, non-electric food storage

coolers, two-way radios and packages of batteries. Gov. Bush signed HB 47 on April 27.

Governmental Entities

One of the most interesting aspects about SB 1980 is the provisions that deal with which governmental entities are now responsible for certain functions.

The biggest change that lawmakers made was placing oversight of Citizens in the hands of the Financial Services Commission (FSC) instead of the OIR. Apparently, lawmakers wanted to make sure that Citizens – soon to become the state's largest property insurer when it assumes customers from the insolvent Poe Financial Group companies – had the attention of the state's top officeholders.

The bill also gives the FSC the responsibility for providing an annual report on PMLs, financing options, potential Citizens and FHCF assessments, and the assessment burden on policyholders.

Meanwhile, the State Board of Administration (composed of the Governor, Chief Financial Officer and Attorney General), working with Citizens, has been given the responsibility to determine how to provide coverage over the next year for policies of insolvent insurers assumed by Citizens.

SB 1980 also specifies that the OIR is authorized to issue orders when the Governor declares a state of emergency, but the FSC is required to adopt rules standardizing requirements that may be applied to insurers after a hurricane, addressing claims report requirements, grace periods for payment of premiums, and temporary postponement of cancellations and non-renewals. It remains to be seen how well this division of labor will work.

As for reports, the OIR is required over the next year to conduct a study on the insurability of attached or free-standing structures; to conduct a study and develop a program to provide an objective rating system that will allow homeowners to evaluate the relative ability of Florida properties to withstand the wind load from a hurricane; and to reevaluate the discounts for homes built to meet the Florida Building Code and to determine the full actuarial value of such discounts.

Conclusion

On balance, Florida's 160 lawmakers probably deserve a grade of "B" for their efforts in crafting the various provisions found in SB 1980.

It appears lawmakers have finally recognized that Citizens' rates are grossly inadequate and phasing in new rates based on new PMLs is a good first step. Likewise, restricting Citizens from writing properties with values in excess of \$1 million also is a positive, but it remains to be seen how quickly some of these property owners will return to the Citizens portfolio once they have been declined by an admitted carrier and three surplus lines carriers.

Primary insurers also appear to have acquired some new found respect among lawmakers as a result of some provisions in SB 1980. The flex-band provision, for example, represents a modest first step in helping to move the homeowners market to a more open and competitively priced market. Again, it remains to be seen how many insurers will be able to avail themselves of this provision, given that many of them probably need rate increases in excess of the parameters allowed by the flex bands. The role of the OIR will be critical in determining whether this provision ultimately succeeds. If regulators are reluctant to declare portions of the state competitive then the provision will not be implemented and the work of the legislators will have been for naught.

Lawmakers also should be commended for their willingness to adopt new strategies to help limited apportionment companies purchase additional reinsurance and for the new "surplus notes" program. These provisions represent a willingness by lawmakers to work with primary insurers and to help encourage them to continue doing business in Florida.

The Legislature also deserves full marks for creating the Florida Comprehensive Hurricane

Damage Mitigation Program that will provide grants to homeowners to make their properties more resistant to storm damage. Going forward, it will be important for lawmakers to encourage citizen participation in the program and to also find ways to make the program permanent, perhaps by creating an endowment as was suggested in the House version of the bill.

In the final analysis, though, the provisions in SB 1980 appear to be mostly "stop gap" in nature, and do little to begin to develop a longer-term strategy to deal with the state's vulnerability to natural disasters.

The public policy question readily acknowledged by many but not being addressed by lawmakers is: how long can they continue to rely on state budget surpluses to help solve current property insurance crises instead of becoming more engaged in a holistic discussion of natural disasters that looks not only at property insurance issues but at land use and additional building restrictions in those portions of the state most at risk for storms.

Going forward, it will be interesting to see whether the prediction of increased storm activity for Florida this coming year comes to fruition or the political changes taking place as a result of November's statewide elections will motivate lawmakers into tackling this important public policy question. In the meantime, Senate Bill 1980 is a good start in that direction.

Note: The author wishes to thank NAMIC's state advocacy partner, the Florida Insurance Council and its staff, for sharing its summary of Senate Bill 1980, which was very helpful in the creation of this Issue Brief.