Property Insurance

The property insurance crisis is the greatest single threat to the economy of our state and to the pocketbook of our citizens that our generation of Floridians have ever faced.

It may sounds like a cliché, but there are no easy answers.

Insurance companies have paid over $30 billion in hurricane losses in Florida over the last two years and hurricane experts predict that we are in an active hurricane cycle that could last 10 to 20 years or longer.

Private reinsurance that insurance companies themselves must purchase in order to have the financial capacity to write additional homeowners insurance, is at the highest price in history and is unavailable at certain levels to some insurers.

This situation naturally results in insurance companies either reducing the coverage that they write in Florida, or increasing their premiums, or both, in order to stay solvent and in order to attract private capital from investors.

An investor in an insurance company would much rather invest in a more predictable line of insurance, such as auto insurance, if the expected rate of return, or profit, is the same as a less predictable, more volatile line of insurance. Given the unpredictable nature of hurricane losses, and the probability over a certain time period of a major hurricane causing an insurer to lose most of its surplus unless it buys substantial reinsurance, the investor naturally demands a greater rate of return, or profit, or to recover greater amounts for its costs of reinsurance than would be required for safer, predictable line of insurance, such as auto insurance.

The idea that some people support, of requiring auto insurers to write homeowners insurance in Florida may sound reasonable, but this will simply either reduce the amount of homeowners insurance in Florida (due to insurers refusing to do business in Florida under these conditions), or reduce the amount of auto insurance in Florida (due to insurers being unwilling to write property at the same level as auto insurance), or both. Regardless, the proposal has no impact whatsoever on the price of property insurance and I seriously doubt that it would meaningfully impact the availability of property insurance. More likely, it would have a detrimental impact on both property insurance and auto insurance.

Others advocate that the state completely take over the hurricane risk. A case can certainly be made for this approach, but it simply means that the taxpayers and policyholders will completely take over the hurricane risk. The claims will still have to be paid, regardless of who pays them. If the state would have taken over the hurricane risk two years ago, the state -- that is, the taxpayers and policyholders -- would have paid, or more accurately, been in debt for, over $30 billion in losses. If the state takes over the risk, we must rely that much more heavily on assessments and taxes in the bad years.

The state and its taxpayers and policyholders have <u>already</u> taken over a substantial portion of the hurricane risk. By creating Citizens Property Insurance Corporation, the state now has the second largest, and soon to be largest writer of property insurance in the state. By creating the Florida Hurricane Catastrophe Fund, the state is the largest single reinsurer of Florida hurricanes. If anyone wants the state and its taxpayers to <u>completely</u> take over the hurricane risk, we should do nothing, because that is where we are headed without meaningful reforms.

2006 Legislation

Senate Bill 1980 has meaningful reforms that are intended to attract private insurance company capital to write more property insurance in the state, to help depopulate Citizens, and to reduce the potential for deficit assessments on policyholders.

However, I am concerned that some of these reforms may have gone too far, regarding the required level of premiums and assessments on Citizens policyholders. It was critical that the Legislature pass a property insurance bill before the hurricane season and we had major policy differences between the House and the Senate that we were forced to compromise.

The House reflected a strong private sector mentality and the desire to do all that was possible to prevent Citizens, the state insurance company, from having a deficit that would be assessed against non-Citizens policyholders. The Senate shared these goals, but preferred a more balanced approach and a recognition that this problem could not be solved in one year. But, the only hope at compromise was for each side to move towards the middle, beyond the comfort level of either side.

We know that these reforms must be continually reviewed and analyzed, and if it becomes clear that some rate increases in Citizens are simply too high, we should consider moderating these provisions in future legislative sessions.

So, let us start with the tough medicine, at least for Citizens policyholders.

The bill requires that the rates for Citizens in the high-risk account, which are the wind-only policies written in most coastal areas of the state, must be set at a level, beginning next year, that will generate sufficient premium revenue to enable Citizens to purchase reinsurance to cover its 70-year probable maximum loss (or "PML"), which is a 1-in-70 year storm, based on approved hurricane loss projection models. In 2008, the rates for the high-risk account must be set at the 85-year PML, and in 2009 must be set at the 100-year PML.

There is concern that this may be too steep an increase over too short a period of time. There is also concern that this approach bases rates in Citizens on the price of private reinsurance, which can fluctuate wildly. We have been informed by Citizens actuaries that this may result in over a 100 percent rate increase over a 3-year period (which follows steep increases in recent years). Nothing like this was proposed in the Senate, but the House insisted on requiring that rates be set at the 100-year PML, so we were at least effective in spreading this requirement over a 3-year period.

But, we also provided that the current requirement that Citizens must charge the highest average rates in a county compared to the "top 20" insurers in the state, will no longer apply in a county or area where OIR determines that no authorized insurer is offering coverage. It is very difficult to justify that Citizens' rates not be competitive, if there is no competition.

The bill also prohibits nonhomestead property from being insured by Citizens, beginning next year, unless the policyholder has affidavits from insurance agents that the property was rejected by at least 1 authorized insurer and at least 3 surplus lines insurers.

A similar provision applies to $1 million dollar homes, but that does not begin until July 1, 2008, and allows for renewal for up to 3 years after that. But, the $1 million homes would be ineligible for coverage beginning in 2011, whether or not coverage is available in the private market. So, we will at least have 5 years to evaluate the impact and to determine if this provision should be retained.

It is important to note that "homestead property" includes many properties that do not qualify for a homestead tax exemption. For example, the definition includes a home that is rented to someone for at least 7 months and which is insured for $200,000 or less. This assures that the landlord will not be forced to increase the rent due to the 10% surcharge provisions that apply to nonhomestead property, and the provisions that force nonhomestead property to attempt to get coverage in the surplus lines market before it can be insured by Citizens. Also, all commercial residential coverage, such as condominium associations and apartment buildings, are considered "homestead property" for purposes of these same provisions.

There is some good news. $715 million dollars was appropriated to offset the 2005 deficit for Citizens. This is expected to reduce an estimated 11 percent regular assessment on all policyholders in the state, to about 2.5%. That is a direct and immediate benefit to all policyholders, thanks to the current state surplus and the hard work of our taxpayers who have contributed to that surplus. There would still remain an additional 8 percent emergency assessment, which the bill requires to be amortized, or collected, over a 10-year period, at about 1 percent per year.

The Legislature allocated $250 million for providing free home retrofit inspections and to provide 50% matching grants of up to $5,000 to homeowners for retrofit improvements. Up to 100% grants of $5,000 will be available to low-income homeowners. This is the closest thing we have to a silver bullet that can reduce the amount of hurricane damage and reduce premiums. But, we also know that $250 million is a small sum compared to all of the homes in the state built before the current Statewide Building Code went into effect. Only a small percentage of homes will be able to obtain grants, based on objective criteria that must be developed by the Department of Financial Services (headed by the Chief Financial Officer). But this is a critical component of a long-term strategy for hardening our older housing stock to withstand hurricane damage. We have made the initial investment and must commit to future investment. You may access information about the "Hurricane Mitigation Program" on the Internet at www.mysafefloridahome.com

$250 million was appropriated to the Insurance Capital Build-Up Incentive Program. We must find a better way for the state and the private market to share the hurricane risk in this state, and we believe that we may have found one. As successful as the Florida Hurricane Catastrophe Fund has been, it has also been criticized for providing reinsurance coverage to insurers at too cheap a price, and thereby exposing our policyholders to an unreasonably high level of risk of assessment. We have addressed that with a rapid cash build up requirement, but we also wanted to explore new alternatives to leveraging public funds towards building a stronger private sector market.

Under this new program, the state would provide a loan to an insurer at favorable interest rates, if the insurer is willing to commit new capital at least equal to the amount of the loan and is willing to write a minimum level of homeowners insurance in the state. The loan is in the form of a "surplus note" that may be counted as an asset by the insurer. This requires that the Insurance Commissioner approve repayment of the principal and interest on the note.

The program gives discretion to our State Board of Administration, headed by the Governor, Attorney General, and Chief Financial Officer, to make the decision whether or not an insurance company has the financial strength and business plan that makes this a good deal for Florida. These are our 3 highest elected officials, so if they cannot be trusted with this decision, I don't know who can. It is new and innovative, and we don't know yet if it will be successful, but we believe the level of state risk is much lower than the other state insurance entities that we have created, and may be the hallmark of a new approach to public-private sharing of the hurricane risk.

<u>We have substantially reformed Citizens to assure that it will never again operate without sufficient controls and standards to prevent the type of mismanagement that occurred in the past.</u> We have:

- Required the Governor and Cabinet to approve Citizens' plan of operation.
- Required the Executive Director of Citizens to be confirmed by the Senate.
- Required Citizens to have an internal auditor.
- Required OIR to do a market conduct examination of Citizens every two years.
- Required the Auditor General to conduct an operational audit of Citizens every three years.
- Required competitive bidding on contracts of $25,000 or more and board approval of contracts of $100,000 or more.
- Required OIR background checks of applicants for senior management positions.
- Subjected board members and senior managers to the code of ethics and financial disclosure requirements applicable to public officials.

- Prohibited board members and employees from accepting any gift from any person or entity under contract with Citizens or under consideration for a contract.
- Prohibited Citizens from retaining lobbyists.
- Prohibited senior managers, for two years following termination of employment, from representing any person or entity before Citizens, or from working for an insurer that received a take-out bonus from Citizens.
- Required employees of Citizens to notify the Division of Insurance Fraud within 48 hours of having information that would lead a reasonable person to suspect that fraud may have been committed by an employee of Citizens.

Other changes for Citizens include:

- Requiring Citizens to offer quarterly and semiannual premium payment plans.

- Allowing Citizens to adopt policy forms that contain more restrictive coverage than provided in the voluntary market.

- Requiring that coverage on mobile homes built prior to 1994 be limited to actual cash value, rather than replacement cost.

- Requiring insurers writing the non-wind coverage to contract with Citizens to provide claims adjusting services for the wind coverage provided by Citizens in the high risk account.

- Requiring that any take-out bonus paid to an insurer be conditioned on the insurer keeping the policy for five years and limiting take-out bonuses to $100 per policy

Insurers are now required to pay 25% more for their Cat Fund coverage, as a rapid cash build-up for the Cat Fund, which is now over $1 billion in debt, after having more than $6 billion in cash just two years ago. Even though this 25% rapid cash build-up factor may increase homeowners rates about 2 to 3 percent, it is desperately needed to assure that further deficit assessments are not imposed on all property and casualty policyholders (including auto insurance policyholders).

Smaller insurance companies, with $25 million in surplus or less, are now allowed to buy additional coverage from the Cat Fund, which will prevent many of these insurers from either going out of business or dropping policies that would have ended up in Citizens.

We have provided positive signals to insurance companies to encourage them to write homeowners insurance in Florida and have required that the Office of Insurance Regulation approve a rate of return for an insurer that is commensurate with the risk of the insurer exposing its surplus to the risk of hurricane losses. This is not guaranteeing any insurer a profit, because the Commissioner of Insurance makes this determination, subject to a hearing if contested by the insurer, and primarily due to the fact that Mother Nature ultimately determines whether an insurer earns a profit. But, we must recognize that the risk of hurricane losses demands a higher rate of return or profit level, as compared to other lines of insurance like auto insurance, in order to offset the catastrophic losses that occur in the bad years that do not happen in most other lines of insurance.

We have also given somewhat greater freedom for insurers to determine the appropriate rate for $1 million dollar homes, by placing the burden on OIR to prove that such rates are excessive. Believe me, no legislator wants to increase rates. But, we have to find certain market segments that should allow for some greater flexibility in order to attract insurers and to help assure that coverage is available in the private market, especially if we provide that such homes will no longer be eligible for coverage in Citizens.

Other important areas addressed by the bill include:

- Providing a neutral arbitration process for sinkhole claims that should reduce the amount paid in attorney fees and help discourage litigation, which is a major factor for policy growth in Citizens in the Pasco and Hillsborough County areas.

- Increasing the funding sources for the Florida Insurance Guaranty Association, to help assure that it can pay claims of insurers that are rendered insolvent after a hurricane and increasing the policy limits paid by FIGA to policyholders of an insolvent insurer from $300,000 to $500,000.

- Prohibiting public adjusters from engaging in conflicts of interest by participating in the repair of damaged property that he adjusted.

CONCLUSION

It is not easy to determine what is truly in the public interest, when all the public cares about, understandably, is how they can possibly afford their insurance premiums. I cannot tell you how much I sympathize with this. I have many friends and relatives who simply cannot afford these rate increases and may be forced to sell their homes or, if they are lucky enough not to have a mortgage, elect to have no coverage at all.

But, we cannot print money and we cannot ask Mother Nature to stop sending hurricanes. All we can do is find win-win solutions like funding mitigation for homeowners, and to do our best to maintain a private insurance market that can share the hurricane risk with the state. The more we do to try to make insurance affordable through stronger rate regulation or limits on amounts charged by state insurance entities, the more we make private coverage less available, and the more we expose all policyholders to increased assessments or taxes. On the other hand, the more we lift restrictions on rates to promote greater availability of coverage in the private market, the less affordable it is likely to become, at least in the short run. Finding the proper balance will be a constant and continuing struggle for this state.

We know that a federal catastrophe fund is essential to a long-term solution, but, to date, Washington has refused to listen and apparently prefers to spend tens of billions of dollars on disaster relief, rather than committing a much lower level of potential federal liability to a preventative, catastrophic insurance plan.

In the meantime, here in Florida we must do our best as we are all in this together. We will gain nothing by viewing this as pitting the interests of Citizens policyholders versus non-Citizens policyholders. Non-Citizens policyholders must recognize that they benefit by having Citizens coverage available when they discover that they need it. Non-Citizens policyholders also benefit by having Citizens, as a last resort insurer, preventing an economic disaster in the state, through mortgage defaults, inability to build or sell homes, and collapse of property values, if property insurance was not available.

This is one state and we must all fight this fight together. Each policyholder should pay a premium that accurately reflects the risk of loss and cost of capital, using the most widely accepted, scientifically proven, publicly approved methods for estimating hurricane losses. But once that premium is paid, we must recognize that all insurance is a subsidy from policyholders who don't have losses, to policyholders that do have losses. That's the nature of insurance. For a state insurance entity, that is likely to result in assessments or taxes when something like 8 hurricanes occur over an 18-month period. The only way to prevent subsidies is to not have insurance and require everyone to pay their own losses as they occur, which may be where we're headed if Mother Nature doesn't give us a break.

But with a little luck, a national catastrophe program as a backstop for a 100-year storm that has still not yet hit Florida in our generation; and a rational approach to a public-private sharing of the state’s hurricane risk, we can build a coordinated program that mitigates and finances hurricane losses in the most efficient way possible. That is our goal and it must be reached.