

# Availability and Cost of Residential Hurricane Coverage

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## **Background**

### **Overview of the Property Insurance Market: Problems and Issues**

Despite significant improvement, the residential property insurance market continues to pose major problems, now 7 years after Hurricane Andrew. These problems include: (1) limited availability and high cost of private market coverage in high risk areas, particularly in coastal areas of Dade, Broward, and Palm Beach Counties; (2) the exposure of the Florida Windstorm Underwriting Association to a multi-billion dollar hurricane loss that would trigger significant premium assessments on all residential policyholders in Florida; and (3) the likelihood that problems of cost and availability of coverage will significantly worsen after another major hurricane.

The Legislature has created two insurance entities to sell property insurance coverage to persons who cannot obtain coverage in the private voluntary market. The Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) offers standard homeowners coverage in all areas of the state. The Florida Windstorm Underwriting Association (FWUA) offers only windstorm coverage, and only in designated coastal areas. These two insurers depend upon debt financing to pay claims in the event of a major hurricane, secured by premium assessments on all property insurance policies in the state.

At the end of July 1999, the RPCJUA insured 113,488 residential structures, a significant decrease in policies over the past 3 years from the 936,837 policies in force in September 1996. However, the FWUA has grown to nearly 457,000 policies with an insured value of \$88 billion, concentrated in Dade, Broward, and Palm Beach counties, and faces an estimated loss of \$5.3 billion from a 100-year storm. A major hurricane striking south Florida would trigger significant assessments on all property insurance policyholders in the state. Most options for reducing the exposure of the FWUA and decreasing this risk of assessments would impose increased costs on FWUA policyholders, such as requiring FWUA policyholders to accept offers of higher priced private coverage, increasing FWUA premiums, and reducing coverage limits in the FWUA. The underlying policy question is to what extent property owners in lower risk areas should help subsidize the cost of hurricane coverage in higher risk areas. This issue has been put into sharper focus by hurricane loss projection models that estimate each area's vulnerability to damage.

## **Guaranteeing Availability of Property Insurance through the FWUA and RPCJUA**

### **Florida Windstorm Underwriting Association (FWUA)**

The FWUA was formed nearly 30 years ago in 1970, under a plan approved by the Department of Insurance as authorized by law, in response to problems of availability of property insurance in certain coastal areas.<sup>1</sup> The FWUA offers coverage only for windstorm and hail losses, and only in those areas where the department determined that windstorm coverage was unavailable and that certain economic conditions existed. Coverage was initially limited to the coastal areas of eight counties, which was expanded to areas in 23 counties by the time of Hurricane Andrew in 1992, and now includes coastal areas in 29 of Florida's 35 coastal counties. In Dade, Broward, and Palm Beach Counties, the entire area east of Interstate 95 is eligible for FWUA coverage (extending up to 5 miles from the coast) and all of Monroe County (the Keys) is eligible, but in other counties eligibility is typically limited to about 1,000 to 1,500 feet from the coast. By act of the Legislature in 1998, further expansion of the eligible boundaries of the FWUA is now prohibited.<sup>2</sup> The boundaries of the FWUA directly affect the obligation of private market insurers to provide windstorm coverage. Outside of FWUA eligible areas, insurers must include windstorm coverage in every residential property insurance policy they write. Inside FWUA areas, insurers are free to write policies that exclude windstorm coverage.<sup>3</sup>

The FWUA insures homes, mobile homes, condominiums, and apartments, as well as commercial business property. A purchaser of a FWUA policy must also obtain a separate policy from another insurer to cover perils other than windstorm, such as fire, theft, and liability. The FWUA operates pursuant to a plan of operation approved by the department and is governed by a 15-member board of directors, including 12 representatives of member insurers and 3 representatives of consumers, including the department's Insurance Consumer Advocate. The FWUA employs a staff located in Jacksonville to administer its operation.

Rates for FWUA coverage must be filed for approval by the board with the

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<sup>1</sup> Ch. 70-234, L.O.F. The current law authorizing the FWUA is contained in s. 627.352(2), F.S. (1998 Supp.)

<sup>2</sup> Ch. 98-173, L.O.F.

<sup>3</sup> Section 627.0629(6), F.S. (1997)

department and are subject to the same rating laws that apply to other residential property insurers. Rates may not be excessive, inadequate, or unfairly discriminatory, based on a variety of factors. Unlike the RPCJUA (discussed below), there is no specific statutory requirement that the rates for the FWUA be tied to highest-price insurers. However, 1997 amendments provide legislative intent that FWUA rates not be competitive with voluntary market rates and requires the plan of operation to provide, by January 1, 1999, a means of assuring that FWUA's rates are reflective of department-approved hurricane rates in the voluntary market.<sup>4</sup>

The FWUA is authorized to assess all Florida property insurers and their policyholders to fund a deficit if premiums are not sufficient to cover claims payments. *Regular assessments* may be made against property insurers, up to 10 percent of the FWUA's deficit, or 10 percent of property insurance premiums in the state, whichever is *greater*. Insurers may later recoup these assessments from their policyholders after getting a rate filing approved. If the deficit exceeds the maximum regular assessment, *emergency assessments* may be imposed on all new and renewal property insurance policies in the state, also limited to the greater of 10 percent of the deficit, or 10 percent of the prior year's statewide premium for property insurance. Unlike regular assessments which an insurer must initially pay out of its own funds, insurers merely collect and remit emergency assessments as policies are written and renewed. An insurer can obtain credits against regular assessments by voluntary writings in FWUA-eligible areas, but not credits against emergency assessments. The board of the FWUA may pledge emergency assessments to secure debt financing.<sup>5</sup>

Hurricanes Opal and Erin in 1995 resulted in a \$117 million deficit assessment that was billed by the FWUA to all property insurers. As these insurers have obtained approval for rate filings after paying their assessment, they have included a one-time annual premium surcharge to recoup the assessment, averaging about 4 to 5 percent of the annual premium, which some policyholders have just recently seen in their premium notices.

Like all residential property insurers, the FWUA must buy reinsurance from the Florida Hurricane Catastrophe Fund, discussed below, which reimburses insurers for a portion of their hurricane losses. In general, this reinsurance provides funding to the FWUA after regular assessments are imposed, but before debt financing and emergency assessments would be necessary. (See Table 5 for the FWUA's 1999 Plan of Finance.)

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<sup>4</sup> Ch. 97-55, L.O.F.; s. 627.351(2)(b)5.b., F.S. (1998 Supp.)

<sup>5</sup> Section 627.351(2)(b)2., F.S. (1998 Supp.)

In 1997, legislation provided that a FWUA policyholder is no longer eligible for coverage with the FWUA if an offer of coverage is made by an authorized insurer to cover the risk at the insurer's approved rates under a policy that includes windstorm coverage. The law states that the FWUA must provide written notice to the policyholder and agent that the FWUA policy will be canceled 60 days after the notice because of the offer of coverage from an authorized insurer.<sup>6</sup> These provisions were modeled on similar provisions in the RPCJUA law.<sup>7</sup> One significant practical difference, however, compared to the situation of an insurer taking a policy out of the RPCJUA, is that requiring a FWUA policyholder to accept a policy from a take-out insurer effectively forces the policyholder to also lose their "other perils" policy with a private market insurer, if the take-out insurer is offering full coverage, not just windstorm coverage.

The FWUA has received offers from insurers to take policies out of the FWUA. However, the board of the FWUA has determined that despite the statutory language, the board will not move forward with any insurer's take-out offer until depopulation procedures have been approved by the department. Depopulation procedures have been adopted by the board of the FWUA and submitted to the department for approval, about which the parties have been engaged in discussions for over a year. These procedures are reportedly close to approval (August 1999). The issues include financial standards for take-out companies, adequate notice to the policyholder, agent, and current other perils insurer, requiring that policies only be taken out upon renewal, approval of the rates and benefits for the take-out insurer's replacement policy, and others. In May 1999, the department approved the first take-out of FWUA policies, discussed in Findings, below.

### **Residential Property and Casualty Joint Underwriting Association (RPCJUA)**

The legislative enactment of the RPCJUA in Special Session of December 1992, was a direct response to the severe market disruption following Hurricane Andrew.<sup>8</sup> The RPCJUA provides residential property insurance statewide, insuring all perils covered under a standard residential policy (except in FWUA-eligible areas, where a RPCJUA policy excludes windstorm coverage). The RPCJUA operates pursuant to a plan of operation approved by the department and is governed by a 13-member board, including 7 members representing

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<sup>6</sup> Ch. 97-55, L.O.F.; s. 627.351(2)(b)1., 4.e., F.S. (1998 Supp.)

<sup>7</sup> Section 627.351(6)(c)5., F.S.

<sup>8</sup> Ch. 92-345, L.O.F.; currently in s. 627.351(6), F.S., (1998 Supp.)

insurers and 6 members representing consumers and other noninsurer interests.

The RPCJUA must charge the same rates charged by the insurer with the highest rates in the county, among the top twenty insurers in the state by premium volume. This requirement was enacted in 1995 and amended in 1996 in an effort to assure that the RPCJUA would be the insurer of last resort, at a time when the RPCJUA was experiencing rapid growth in policies and exposure.<sup>9</sup>

The RPCJUA may impose regular and emergency assessments to fund deficits and may pledge emergency assessments to secure debt financing, under the same limitations that apply to the FWUA, as previously discussed. It must also obtain reinsurance from the Florida Hurricane Catastrophe Fund at the same level as the FWUA.

Beginning in 1995, the Legislature, Department of Insurance, and the RPCJUA focused on depopulation of the RPCJUA by encouraging insurers to take policies out of the RPCJUA, including cash bonuses and exemptions from assessments. Depopulation of the RPCJUA is discussed in Findings, later in this report.

## **Other Property Insurance Laws Affecting Availability and Affordability of Coverage**

### **Florida Hurricane Catastrophe Fund**

The Florida Hurricane Catastrophe Fund, commonly referred to as the “Cat” Fund, is a state trust fund administered by the State Board of Administration (SBA), created in 1993 to reimburse residential property insurers for a portion of their hurricane losses.<sup>10</sup> The Fund collects premiums on a tax-exempt basis and provides additional reinsurance capacity at lower rates than can be obtained from private reinsurers. The Fund serves to increase the amount of property insurance that insurers are able to write, lowers its cost, and helps assure that claims are paid in full after a hurricane. All residential property insurers must buy reinsurance from the Fund for either 45 percent, 75 percent, or 90 percent of their hurricane losses, as selected by the insurer, above a certain retention, which is about \$3.1 billion for all insurers combined. The FWUA and RPCJUA must buy coverage at the 90 percent reimbursement level.

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<sup>9</sup> Chapters 95-276 and 96-377, L.O.F.; current law in s. 627.351(6)(d)2., F.S. (1998 Supp.). The 1995 law tied the RPCJUA’s rates to the top 10 insurers in the state by premium volume, amended by the 1996 law to the top 20 insurers.

<sup>10</sup> Ch. 93-409, L.O.F.; currently in s. 215.555, F.S. (1998 Supp.)

Insurers must pay a premium for their Cat Fund coverage, which totaled \$440 million for the 1998 contract year. The SBA selects an independent consultant to develop a formula for determining the actuarially indicated premium to be paid, which must be approved by unanimous vote of the SBA (Governor, Treasurer, and Comptroller). Cat fund rates for 1999 are based on an average of three hurricane loss projection models approved by the Florida Commission on Hurricane Loss Methodology (discussed below). To meet Fund obligations, the SBA is authorized to issue revenue bonds, supported by a maximum emergency assessment that it may direct the Department of Insurance to levy on each insurer writing property and casualty business in Florida.

Significant changes were made to the Cat Fund by 1999 legislation in order to preserve its claims-paying capacity for subsequent seasons after a major hurricane.<sup>11</sup> The prior law limited the Fund's obligations only by the amount of hurricane losses and the maximum funds the SBA could obtain through issuing revenue bonds, supported by a maximum 4 percent assessment on property insurance policies. If the Fund exhausted its bonding capacity, Cat Fund coverage for succeeding years would be limited to its premium revenue and insurers would be forced to replace Fund coverage with more expensive private reinsurance, if available, creating market problems of non-renewals and higher rates similar to the post-Andrew market. To mitigate against these effects, the 1999 legislation limited the total amount that the Fund may pay all insurers for hurricane losses to \$11 billion for any one year and limited each insurer's annual payment from the Cat Fund to the insurer's minimum guarantee, which generally equals each insurer's proportionate share of Cat Fund premiums. However, the FWUA and the RPCJUA are *not* be subject to the latter limitation. The 1999 act also increased the maximum assessment that can be imposed on property and casualty policies in any one year from 4 percent to 6 percent to fund bonds issued by the SBA to fund Cat Fund obligations, but limited to 4 percent for hurricanes occurring in any one contract year.

The Cat Fund will have approximately \$3 billion in cash reserves at the end of 1999 and it is estimated that the SBA would need to impose an assessment of about 3.7 percent on property insurance premiums to issue an additional \$8 billion in revenue bonds, if necessary to pay the maximum \$11 billion reimbursement to insurers for hurricane losses in 1999.

### **Rate regulation; Arbitration**

Florida's insurance laws require insurers to file property and casualty insurance rates for approval with the department either 90 days before the proposed

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<sup>11</sup> Ch. 99-217, L.O.F.

effective date or 30 days after the rate filing is implemented. Under the latter option, however, the department may order the insurer to refund that portion of the rate determined to be excessive, so it is rarely utilized.<sup>12</sup> If the department disapproves a rate filing, the insurer may request an administrative hearing under the Administrative Procedures Act.<sup>13</sup> Until 1996, this process was the insurer's only administrative remedy, and the lengthy delay and perception that a court would be unlikely to reverse a final order of the department typically led to a consent agreement between the department and the insurer.

In 1996, the law was amended to allow insurers to request arbitration of a rate filing as an alternative to an administrative hearing.<sup>14</sup> After the department issues a notice of intent to disapprove a rate filing, the insurer may request arbitration before a panel of three arbitrators.<sup>15</sup> The panel is chosen as follows: one is selected by the insurer, one by the Department, and the third is chosen by the two other arbitrators. An arbitrator must be certified by the American Arbitration Association and may not be the employee of any insurance company or insurance regulator. The procedures outlined in the Arbitration Code (chapter 682, F.S.) are applied to rate arbitration and the costs of arbitration are paid by the insurer. The decision of the panel constitutes the final approval of a rate filing.

Either party to the arbitration proceeding may apply to the circuit court to vacate or modify the panel's decision as provided in ss. 682.13 and 682.14, F.S. In general, grounds for vacation include corruption or fraud, evident partiality by a neutral arbitrator, and action beyond the arbitrators' powers or jurisdiction. Grounds for modification include miscalculations, errors as to form, and actions on matters not submitted for arbitration. Upon initiation of arbitration, the

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<sup>12</sup> Section 627.062, F.S. (1997)

<sup>13</sup> Under the APA, a company which disputes the material facts which are the basis for the Department's rate decision may request a formal adversarial proceeding under section 120.57(1), F.S. These proceedings are held before a State administrative law judge of the Division of Administrative Hearings. Once the hearing is completed, the judge issues his or her decision, termed a Recommended Order, to the Insurance Commissioner for final review. In turn, the Commissioner issues a Final Order, which may be appealed to the First District Court of Appeal.

<sup>14</sup> Ch. 96-194, L.O.F., amending s. 627.062(6), F.S.

<sup>15</sup> In 1997, the department adopted rules for arbitration (Rule 4-170.101-137, F.A.C.).

insurer waives all rights to challenge the action of the Department of Insurance under the APA or any other law; however, these rights are restored to the insurer if the arbitrators fail to act within 90 days after initiation of arbitration. Since the inception of the arbitration provision, four insurance companies and the FWUA have requested arbitration. Table 1 below features the requested rate change and the final decision by the arbitration panel.

**TABLE 1**  
**ARBITRATED RATE FILINGS**

<b>Company Name</b>	<b>Filing Received</b>	<b>Filing Type</b>	<b>Requested Rate Change</b>	<b>Arbitration Decision</b>
State Farm Fire & Casualty	May 5, 1997	File & Use	25.60%	25.60%
Fidelity & Casualty of New York (CNA)	August 14, 1997	Use & File	28.10%	Remand filing to Department *
Florida Windstorm Underwriting Assn.	August 25, 1997	File & Use	61.00%-This rate change was to be implemented over 3 years.	12.0%**
United Services Automobile Assn./USAA Casualty Insurance Company	September 2, 1997	File & Use	19.40%	14.80%
Nationwide	December 17, 1998	File & Use	27.00%	Currently in Arbitration
Florida Windstorm Underwriting Assn.	May 3, 1999	File & Use	128.00%***	Currently in Arbitration

Source: Department of Insurance (Data as of 8/30/99)

\*On August 27, 1998, the Department of Insurance issued a Consent Order approving a 12.8% average rate increase for CNA, but prohibited the company from filing for a homeowners rate increase prior to January 2000. However, CNA could submit a filing prior to January 2000, for the department's consideration, if such filing is made in response to economic or catastrophic events beyond its control.

\*\*The Arbitration Order awarded the FWUA a one year 12% premium increase, effective August 1, 1998, without prejudice to refile for an additional increase after one year. Additionally, the increase was capped so that no existing policyholder would receive an increase in their premium level of greater than 40%.

\*\*\*Representatives with the FWUA state that the actual statewide average rate increase would be much lower than 128% and be in the 60-80% range if a policyholder mitigates and thus lowers his/her premium. The FWUA offers various cost saving features in its filing so that insureds will receive a fiscal incentive to retrofit their home, or where feasible, include retrofitting features in the construction of a new home. Additionally, there will be a 40% cap on any premium increase at each renewal.

#### Hurricane Loss Projection Models; Methodology Commission

Insurers and regulators have become increasingly dependent on hurricane loss projection models to estimate the expected losses from hurricanes, particularly after Hurricane Andrew. The premiums that insurers are required to pay for coverage from the Florida Hurricane Catastrophe Fund are based on models that have met the standards approved by the Florida Commission on Hurricane Loss Projection Methodology, which was created by act of the Legislature in 1995. Also, the Department of Insurance requires insurers to use hurricane models to determine the amount of surplus and reinsurance needed in order for the insurer to be approved for taking a block of policies out of the RPCJUA or FWUA. Yet, the department has also been critical of insurers' reliance on models in establishing premium rates.

The 1995 law creating the Commission on Hurricane Loss Projection Methodology provides legislative findings and intent that reliable projections of hurricane losses are necessary to assure that rates for residential property insurance are neither excessive nor inadequate; that the ability to make these projections has been greatly enhanced by the development of computer models; that it is the public policy of the state to encourage the use of the most sophisticated actuarial methods to assure that rates are lawful; and that there is a need for expert evaluation of the models.<sup>16</sup> The Commission is administratively housed in, but independent of, the State Board of Administration and is composed of eleven members: the Insurance Consumer Advocate of the Department of Insurance, the Chief Operating Officer of the Florida Hurricane Catastrophe Fund, the Executive Director of the RPCJUA, the Director of the Division of Emergency Management of the Department of Community Affairs, the actuary member of the Florida Hurricane Catastrophe Fund advisory council, and the following six members appointed by the Insurance Commissioner: a department actuary, a private sector actuary, and four State University System faculty members with expertise in insurance finance, statistics, meteorology, and computer system design.

The Commission has adopted standards and specifications of acceptable computer models and as of August 1999 has approved five different models as having met these standards. The original 1995 act provided that the findings of the Commission were binding on the department except in certain circumstances, but amendments in 1996 provided, instead, that the findings and models approved by the commission are *admissible and relevant* in the

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<sup>16</sup> Ch. 95-276, L.O.F.; current law in section 627.0628, F.S. (1997).

department's consideration of a rate filing or in any administrative or judicial review of the department's actions.<sup>17</sup>

### **Moratorium on Non-renewing Residential Policies**

Since 1993, Florida law has either prohibited or limited the number of residential insurance policies that an insurer may cancel or non-renew for the purpose of reducing hurricane exposure, referred to as moratorium on cancellations and nonrenewals. The current restrictions are scheduled to be repealed on June 1, 2001 and apply only to policies that were in effect on June 1, 1996. Prior versions of the moratorium were scheduled for repeal in 1996 and 1999, respectively, but were extended and modified by the Legislature prior to repeal.<sup>18</sup>

The current law prohibits insurers from non-renewing, in any 12-month period, more than 5 percent of their residential property insurance policies in the state that were in effect on June 1, 1996, or more than 10 percent of their policies in any one county in any 12-month

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<sup>17</sup> Ch. 96-377, L.O.F.

<sup>18</sup> The current law is contained in ss. 627.7013 and 627.7014, F.S. (1998 Supp.). The first moratorium was enacted in Ch. 93-401, L.O.F., which prohibited insurers from canceling or nonrenewing residential policies on the basis of risk of hurricane claims for 180 days, from May 19, 1993 until November 14, 1993. In a November Special Session of that year, Chapters 93-411 and 93-412, L.O.F., amended the moratorium to provide that for the 3-year period from November 14, 1993 through November 14, 1996, insurers were prohibited from canceling or non-renewing more than 5% of their residential policies statewide or 10% in any one county, in any 12-month period, for reasons of reducing hurricane exposure, subject to a waiver by the department on the basis of the insurer's historic cancellation/nonrenewal rate or to avoid an unreasonable risk of insolvency. In 1996 (Ch. 96-194, L.O.F.) the Legislature imposed a new, 3-year "moratorium completion" that applied to policies in force on June 1, 1996. The same percentage limitations on non-renewals were imposed, but policies transferred from an insurer to another Florida authorized insurer did not count as a non-renewal, and the department was authorized to approve accelerated exposure reduction plans for nonrenewals that would place wind coverage with the FWUA if the insurer retained the other perils policy, subject to a statewide cap of 30% of policies. In 1998 (Ch. 98-173, L.O.F.), the Legislature again extended the expiration date of the current moratorium from June 1, 1999, until June 1, 2001, with the same percentage limitations, but continuing to apply the limitations only to policies in effect on June 1, 1996. The 1998 law also repealed provisions allowing insurers to obtain approval for an accelerated exposure reduction plan in FWUA-eligible areas.

period, for the purpose of reducing hurricane exposure. Exceptions are provided for insurers that can demonstrate an unreasonable threat to their solvency and insurers may transfer policies to another authorized insurer without it counting as a nonrenewal. The previous version of the moratorium allowed insurers that had an over-concentration of wind risks in FWUA areas to apply to the department for approval of an increased number of non-renewals of the windstorm portion of the policy, if replaced by FWUA coverage. State Farm and Allstate received approval for such exposure reduction plans which had a significant impact on FWUA policy growth. (See, *Growth in FWUA Policies and Exposure*, below.)

### **Hurricane Deductibles**

Florida law limits the maximum and minimum hurricane deductibles that may be offered by residential property insurers and requires that certain deductibles be offered.<sup>19</sup> In practice, this results in most homeowners being given two options for a hurricane deductible -- either 2 percent or 5 percent of policy limits.

More specifically, for homes valued under \$100,000, the insurer must offer a \$500 hurricane deductible and a 2 percent of policy limits hurricane deductible. For homes valued in excess of \$100,000 the insurer must offer the 2 percent deductible, but the \$500 deductible need not be offered if the insurer guarantees that it will renew the policy for another year. The maximum allowable deductible is 2 percent for homes valued under \$100,000, 5 percent for homes valued between \$100,000 and \$500,000, and unlimited for homes valued in excess of \$500,000. On mobile homes, the law allows a hurricane deductible up to 5 percent of the value when there is a lien on the mobile home, and up to 10 percent for mobile homes without any liens. For condominium association and cooperative association policies, the maximum allowable hurricane deductible is 5 percent of the insured value, but the insurer must offer a 3 percent deductible. For other commercial residential structures, like apartment buildings, the maximum hurricane deductible is 10 percent, but the insurer must offer a 3 percent deductible, and may offer any deductible in between.

Based on the current law definitions, the hurricane deductible applies if windstorm losses are *caused by or resulting from a hurricane*.<sup>20</sup> On a case by case basis it may be difficult to

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<sup>19</sup>Section 627.701, F.S. (1997)

<sup>20</sup>Section 627.4025, F.S., defines *hurricane coverage*, *windstorm*, and *hurricane* as these terms are used in policies providing *residential coverage*, also defined. *Hurricane coverage* is defined (in part) as coverage for loss or damage caused by the peril of windstorm during a hurricane. *Windstorm* for purposes of this definition, means wind, wind gusts, hail, rain, tornadoes, or cyclones *caused by or resulting from a hurricane* which results in direct physical loss or damage to property. *Hurricane* means a storm system that has been declared to be a hurricane by the National Hurricane Center of the National Weather Service.

determine whether a windstorm loss in a particular county or area was caused by or resulting from a hurricane, particularly if the wind speed is below hurricane force winds (which is very difficult to determine) and is geographically distant from the center of the storm system.

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The duration of the hurricane includes the time period, in Florida, beginning at the time a hurricane watch or hurricane warning is issued for any part of Florida, continuing for the time during which hurricane conditions exist anywhere in Florida, and ending 72 hours following the termination of the last hurricane watch or hurricane warning issued for any part of Florida.

## **Methodology**

The property insurance laws enacted since Hurricane Andrew in 1992 and previous legislative reports on this subject were reviewed and summarized for the background section of this report. Numbers of policies, insured value, estimated losses, current financing plans, and summaries of historical depopulation activities for the Residential Property and Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association were obtained for each of these associations and summarized in this report. Average statewide percentage increases in residential property insurance rates since 1992 for the top ten insurers in the state in 1994 were obtained from the Florida Department of Insurance. The department also provided, upon request, the percentage rate increase filed for all rate filings submitted to arbitration and the determination of the arbitration panel. At the committee's request, the department provided a premium rates comparison for the hurricane rate and the non-hurricane rate in Broward, Dade, Palm Beach, and certain other counties, for the FWUA, RPCJUA, State Farm, Allstate Floridian, and the two insurers that charge the highest and lowest rates among the top 18 writers in those counties, for homes valued at \$75,000, \$150,000, and \$300,000 with hurricane deductibles of \$500 and 2 percent of policy limits. Interviews were conducted with representatives of the Florida Market Assistance Plan (FMAP) and with insurance agents whose names were provided by FMAP regarding the availability of property insurance in south Florida.

## Findings

### FWUA: Exposure to Losses; Financing Losses

#### Growth in FWUA Policies and Exposure

The FWUA experienced significant growth in policies and exposure after Hurricane Andrew in 1992, leveling off in December of 1998, and in June and July of 1999 the policy count dropped, due to the first approved take-out plan. The FWUA reports that it is currently writing about 2,100 new policies per month. As of July 31, 1999, the FWUA had 456,958 policies in force, with a total insured value of \$88 billion. Approximately one-half of both the policies and exposure are concentrated in Dade, Broward, and Palm Beach counties. Table 2 below, shows the policy count and exposure, beginning three months after Hurricane Andrew, to the present.

**Table 2**  
**FWUA POLICY COUNT AND INSURED**  
**VALUE**  
**1992-1999**

<b>Date</b>	<b>Policies in Force</b>	<b>Insured Value (\$ Billion)</b>
Dec., 1992	61,793	\$7.5
Dec., 1993	115,588	\$15.3
Dec., 1994	184,010	\$27.0
Dec., 1995	229,548	\$36.3
Dec., 1996	282,824	\$49.5
Dec., 1997	417,342	\$75.4
Dec., 1998	499,711	\$91.1
July, 1999	456,958	\$88.0

A significant factor in the growth that occurred during 1997 and 1998 were non-renewals of wind coverage in FWUA areas by the state’s two largest voluntary market insurers, State Farm and Allstate. These two insurers received approval from the Department of Insurance for an “accelerated exposure reduction plan,” pursuant to a statutory exemption from the percentage moratorium limitations on nonrenewals. More recently, in June and July of this year, Clarendon Insurance Company removed about 37,000 policies from the FWUA, becoming the first insurer to obtain approval from the department to do so. Clarendon also removed a large number of RPCJUA policies and received the largest cash bonuses awarded to date, discussed in more detail in **RPCJUA and FWUA Depopulation Programs**, later in this report. Clarendon is also the first insurer other than the FWUA to write wind-only policies, which enables the former FWUA policyholders to maintain their other perils coverage with a different insurer.

As reflected in Table 3, below, over one-half of the policies and exposure of the FWUA are concentrated in the three counties of Dade, Broward, and Palm Beach.

**TABLE 3**  
**FWUA POLICIES AND INSURED VALUE**  
**DADE, BROWARD, AND PALM BEACH COUNTIES**  
**VS. REST OF STATE**  
**(AS OF 7/31/99)**

<b>County</b>	<b>Policies in Force</b>	<b>Percentage of Total Policies</b>	<b>Insured Value</b>	<b>Percentage of Total Value</b>
Dade	96,923	21.2%	\$20.5	23.3%
Broward	84,399	18.5%	\$14.0	15.9%
Palm Beach	63,951	14.0%	\$13.7	15.5%
3-County Total	245,273	53.7%	\$48.2	54.7%
Rest of State	211,685	46.3%	\$39.8	43.3%
Statewide Total	456,958	100%	\$88.0	100%

### **Estimate of FWUA Losses**

The FWUA estimates its projected hurricane losses, by contracting with an actuarial firm that has developed hurricane loss projection models that meet the standards approved by the Florida Hurricane Loss Methodology Commission. The model includes estimates of the expected average annual loss, and the probable maximum loss that will occur over various time periods, as summarized on Table 4, below.

**TABLE 4  
ESTIMATED PREMIUMS AND LOSSES FOR FWUA\***

<b>Estimated FWUA Premiums for 1999 = \$305,401,993</b>	
<b>Estimated Average Annual FWUA Loss for 1999 State Total = \$317,892,294</b>	
Dade Co.	\$111,246,441 (35% of total)
Broward Co.	\$62,702,222 (19.7% of total)
Palm Beach Co.	\$47,692,050 (15.0% of total)
Monroe Co.	\$40,775,935 (12.8% of total)
Rest of State	\$55,475,646 (17.5% of total)
<b>Probable Maximum Loss:</b>	
10-Year Storm	(10% Annual Loss Probability) = \$671 mil.
20-Year Storm	(5% Annual Loss Probability) = \$1.5 bil.
50-Year Storm	(2% Annual Loss Probability) = \$3.2 bil.
100-Year Storm	(1% Annual Loss Probability) = \$5.3 bil.
250-Year Storm	(0.4% Annual Loss Probability) = \$8.0 bil.
500-Year Storm	(0.2% Annual Loss Probability) = \$10.2 bil.

(\*Loss projections estimated for the FWUA in August 1999 by Applied Insurance Research, based on \$97.7 billion in value exposed to hurricanes in Florida with approximately 23% of FWUA's exposure concentrated in Dade County.)

Source: Florida Windstorm Underwriting Association

## Financing the Payment of FWUA Claims

As shown on Table 4, above, the estimated *average annual loss* for the FWUA for 1999 is greater than the *annual premium* collected by the FWUA, which indicates that current funding may not be at adequate levels. Premiums should be expected to cover average annual hurricane losses plus amounts necessary to cover non-hurricane wind losses, agents commissions, and other expenses of administration. The *probable maximum loss* as shown on

Table 4 is used to determine the funding needed to pay claims for the single largest storm that is likely to occur over a specified time period. An insurer is generally expected to have the ability to pay claims, from its surplus and reinsurance, in an amount sufficient to covers its estimated loss for a *100-year storm* in order to obtain an acceptable insurance rating from

private rating organizations and as a condition of obtaining approval from the Department of Insurance for a take-out plan to write policies out of the RPCJUA or FWUA. The FWUA, however, is forced to depend upon debt financing to fund its 100-year storm estimate of \$5.3 billion, which has been secured for 1999. The funding sources for the FWUA's 1999 finance plan, to pay up to \$5.361 billion in claims, are illustrated on Table 5, below.

**Table 5**  
**Florida Windstorm Underwriting Association**  
**1999 PLAN OF FINANCE**

<b><u>\$LOSS</u></b>	<b>POST-EVENT BONDS \$(?)</b> Source: Emergency Assessments Levied Statewide on Property Policies	
<b>5.361 Billion</b>		
	<b>LINE OF CREDIT</b> <b>\$800 MILLION</b> Source: Emergency Assessments Levied Statewide on Property Policies	
<b>4.561 Billion</b>		
	<b>PRE-EVENT NOTES</b> <b>\$1.500 BILLION PORTION</b> Source: Premium Revenue and Emergency Assessments	
<b>3.061 Billion</b>		
	<b>FWUA RETENTION</b> <b>(10%)</b>  (Pre-event Notes \$250 Million)	<b>FLA. HURRICANE CAT. FUND RECOVERY (90%)</b> <b>\$2.243 Billion</b> <b>(Residential Only)</b>  Source: (i) FHCF Surplus (ii) Assessments on Property & Casualty Companies
<b>3.061 Billion</b>		
	<b>MARKET EQUALIZATION SURCHARGE</b> <b>\$60 MILLION PORTION</b> Source: Recoupment for Residual Market Policyholders	
<b>568 Million</b>		
	<b>REGULAR ASSESSMENT</b> <b>\$448 Million</b>  Source: Recoupment from Member Company Policyholders	
<b>508 Million</b>		
	<b>CASH ON HAND</b> <b>\$60 Million</b>	
<b>60 Million</b>		

Source: Florida Windstorm Underwriting Association

As shown on Table 5, above, the FWUA has only \$60 million cash on hand, a small figure compared to the loss estimates in Table 4. Even relatively minor hurricane losses would trigger regular assessments against insurers (up to \$448 million, which is 10 percent of premium), which would be recouped from their policyholders, and the FWUA would impose equivalent market equalization surcharges (\$60 million) on FWUA policyholders. These three sources combined generate a total of \$568 million, which is below the estimated losses for a 10-year storm of \$671 million, and well short of the losses from a 20-year storm, estimated at \$1.8 billion. Storms of such magnitude would trigger the next layer of funding, which is the estimated \$2.2 billion recovery from the Florida Hurricane Catastrophe Fund for 1999. This is a significant layer of funding, and when added to underlying sources, comes close to funding the 50-year storm loss estimate of \$3.2 billion. But, this would trigger Cat Fund assessments on property insurers of 3 to 4 percent of premiums, assuming proportionate losses by other insurers, and would also require use of \$250 million in pre-event notes that the FWUA has obtained (funds that have already been borrowed) to pay for the 10 percent retention of claims not paid by the Cat Fund. Beyond about \$3.0 billion in losses, the FWUA funding is solely dependent upon debt financing, secured by emergency assessments, limited only by what the capital markets will bear.

### **RPCJUA: Policy Count and Exposure**

After its creation in 1992, the Residential Property and Casualty Joint Underwriting Association grew to a peak of 936,000 in-force policies in September 1996. Since that time, the policies and exposure of the RPCJUA have been steadily reduced, as shown on the following table:

**TABLE 6**  
**RPCJUA POLICY COUNT AND INSURED VALUE**  
**SEPTEMBER 1996 TO JULY 1999**

<b>Date</b>	<b>Policies In Force</b>	<b>Insured Value (\$ Bil.)</b>
September, 1996	936,837 (highest)	\$98.3 (highest)
December, 1996	705,988	\$78.1
July, 1997	613,353	\$73.4
December, 1997	487,590	\$60.5
July, 1998	280,214	\$42.2
December, 1998	256,753	\$38.6
March, 1999	211,413	\$31.9
July, 1999	113,488	\$18.4

Source: Residential Property & Casualty Joint Underwriting Association

The policies that remain in the RPCJUA are heavily concentrated in Dade, Broward, and Palm Beach Counties, as shown on Table 7, below.

**TABLE 7**  
**RPCJUA POLICIES AND INSURED VALUE**  
**DADE, BROWARD, AND PALM BEACH COUNTIES VS. REST OF**  
**STATE**  
**(AS OF 7/31/99)**

County	Policies in Force	Percentage of Total Policies	Insured Value (\$ bil.)	Percentage of Total Value
Dade	53,902	47.5%	\$7.45	40.5%
Broward	27,461	24.2%	\$4.61	25.0%
Palm Beach	23,481	20.7%	\$5.62	30.5%
3-County Total	104,844	92.4%	\$17.68	96.0%
Rest of State	8,644	7.6%	\$0.73	4.0%
Statewide Total	113,488	100%	\$18.41	100%

Source: Residential Property & Casualty Joint Underwriting Association

## RPCJUA AND FWUA Depopulation Programs

### RPCJUA Depopulation

During the 1995 session, legislation was enacted establishing statutory guidelines for the depopulation of the RPCJUA.<sup>21</sup> Since the inception of the RPCJUA in December 1992, the number of policies within the association had increased dramatically and the Legislature became concerned not only about the growth of the RPCJUA, but about the potential deficit assessments against insurance companies that could result from a catastrophic loss to the

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<sup>21</sup> See s. 627.3511, F.S., as created by Ch. 95-276, Laws of Florida (CS/HB 2619). A depopulation program is a set of incentives designed to encourage insurance companies to take over risks insured by a residual market entity like the RPCJUA (“take-out plan”) or is designed to provide coverage for a risk that would otherwise become an applicant for residual market coverage (“keep-out plan”). The legislation applied only to personal lines residential risks.

association.<sup>22</sup> This sentiment was echoed in the legislative findings and intent section of the bill which specifically noted that “extraordinary measures” were needed to reduce the number of policies in the RPCJUA and thus a “variety of financial incentives” were necessary to encourage replacement of RPCJUA policies with policies written by admitted insurers at approved rates.

Under the statutory scheme, companies could receive up to a \$100 per policy bonus for take-outs of at least 25,000 policies subject to approval by the association board.<sup>23</sup> Such bonuses would be funded through premium revenues and the take-out insurer would be required to provide coverage for at least 3 years.<sup>24</sup> Additionally, the Legislature gave the association the authority to offer a limited exemption from regular assessments the RPCJUA could impose on insurance companies if it incurred a deficit from a hurricane or other large loss. These deficit assessment exemptions would apply to the policies an insurer removed from the RPCJUA and would decline over time as follows: in the first year after the policy was removed, it was fully excluded from calculation of the insurer’s assessment liability; in the second year, it was excluded to the extent of 75 percent; and, in the third and final year of the exemption, it was excluded to the extent of 50 percent.<sup>25</sup> Pursuant to this legislative authorization, the RPCJUA approved 3 companies to participate in this incentive program and collectively the companies removed approximately 183,387 policies.<sup>26</sup>

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<sup>22</sup> By January 1995, the RPCJUA had nearly 700,000 policies in force and structure exposures of nearly \$50 billion.

<sup>23</sup> The Department of Insurance could disqualify an insurer’s take-out plan based on criteria delineated in s. 627.3511, F.S., within thirty days after board approval.

<sup>24</sup> The \$100 per policy take-out bonus is held by the RPCJUA in escrow until completion of the 3-year period.

<sup>25</sup> These exemptions were available *only* if certain other conditions were met by the take-out companies: (1) The take-out company must remove at least 50,000 RPCJUA policies; (2) At least 40% of the removed policies must be located in Dade, Broward, and Palm Beach counties, or 30% must be located in those 3 counties *and* an additional 50% of the policies must cover properties in other coastal counties; (3) The insurer’s Florida market share for any line of property insurance must not have exceeded 0.1 percent at any time during the 5 years preceding removal of the risks from the RPCJUA.

<sup>26</sup> This incentive take-out initiative was referred to as the Pre-Open House program and the following take-out companies were approved to participate in the program by the RPCJUA between July and October 1995: AIB Insurance Group, Argus Fire and Casualty Insurance Company, and Bankers Security

Under a separate section of the 1995 bill, the Legislature granted the RPCJUA broader general authority to develop additional depopulation incentives to reduce both new and renewal policies than the specific depopulation criteria outlined in s. 627.3511, F.S.<sup>27</sup> In 1996, the Legislature again addressed the depopulation issue by allowing similar incentives for take-out plans involving commercial residential risks.<sup>28</sup> The following year, legislation was enacted authorizing the Florida Windstorm Underwriting Association to grant exemptions from FWUA assessments as an incentive for insurers to remove policies from the RPCJUA.<sup>29</sup> This legislation also revised procedures for payment of incentive bonuses for RPCJUA take-out plans.<sup>30</sup> Two years later, the 1999 Legislature repealed the provision that prohibited the association from offering take-out bonuses and assessment exemptions to insurers that take policies out of the RPCJUA when the policy count of the association falls below 250,000.<sup>31</sup> At the time the legislation was introduced, there were 212,704 policies in the association. Utilizing these legislative authorizations, the association has been able over the past several years to implement a series of take-out programs, outlined below, that offer a variety of cash bonuses and assessment exemptions as incentives for insurance companies to remove policies.

*Open House Program* - In November 1995, the RPCJUA launched its Open House Program which included the following take-out incentives:

- ◆ three-year, 100% exemptions from RPCJUA regular deficit assessments by removing a minimum of 1,000 policies

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Insurance Company.

<sup>27</sup> See s. 627.3511(6)(g)3.a., F.S. After the 1995 law was enacted, there was some confusion as to the meaning and intent of this broader depopulation authority pursuant to s. 627.3511(6)(g)3.a., F.S., which did not contain the numerical or geographic restrictions outlined under s. 627.3511, F.S. Based on the opinion of the RPCJUA general counsel that the broader depopulation authority superseded the restrictions in s. 627.3511, F.S., the association board approved take-out plans in excess of \$100 per policy. For an excellent discussion of this issue as well as the depopulation of Florida's residual property insurance market, see *Status Report: Growth and Depopulation in the Residual Property Insurance Market*, Committee on Financial Services, Florida House of Representatives, October 1998.

<sup>28</sup> See s. 627.3511(6), F.S., as created by Ch. 96-194, L.O.F. (CS/SB 2314).

<sup>29</sup> See s. 627.351(2), F.S., as created by Ch. 97-55, L.O.F. (CS/SB 794).

<sup>30</sup> See s. 627.3511, F.S., as created by Ch. 97-55, L.O.F. (CS/SB 794).

<sup>31</sup> See s. 627.3511, F.S., as created by Ch. 99-142, L.O.F. (SB 1464).

- ◆ eligibility for receiving a \$40 per policy bonus for removing 5,000 to 12,499 policies, a \$60 per policy bonus for removing 12,500 to 24,499 policies and a \$100 per policy bonus for removing 25,000 policies in certain geographic locations<sup>32</sup>

Under this program twelve companies collectively removed approximately 421,839 policies from the RPCJUA.<sup>33</sup>

*Market Challenge Program* - In February 1997, the RPCJUA initiated its second formal take-out program which was developed to continue the success of its Open House Program. The Market Challenge Program consisted of three phases which offered the same incentives as those offered under the Open House Program. However, under Phase Two of the Market Challenge Program, the association offered companies a flat rate of \$100 per policy to remove as least 10,000 mobile home policies. This offer was due to the fact the RPCJUA had 73,000 mobile home policies. Under the three phases of the Market Challenge Program, twelve insurers collectively removed approximately 360,104 policies, of which 58,000 were mobile home policies.<sup>34</sup>

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<sup>32</sup> To receive full payment under the take-out bonus program a *new insurer* must take-out at least 30% of its policies from Dade, Broward and Palm Beach counties, or at least 39% of its policies from Dade, Broward, Palm Beach, Pinellas and Hillsborough counties. For *existing insurers*, if the insurer has more than 30% of its Florida personal residential policies in Dade, Broward and Palm Beach counties, the percentage of policies being taken out in Dade, Broward and Palm Beach counties may be lower than 30%, but not lower than 15%, so long as the final percentage of the insurer's personal residential policies in Dade, Broward or Palm Beach counties is 30% or greater; or, if the insurer has less than 30% of its Florida personal residential policies in Dade, Broward and Palm Beach counties, the insurer must take out at least 30% of its policies from Dade, Broward and Palm Beach counties.

<sup>33</sup> These companies were: American Summit Insurance Co., Companion Property and Casualty Insurance Co., First Floridian Insurance Co., Florida Family Mutual Insurance Co., Florida Farm Bureau Insurance Co., Florida Select Insurance Co., Horace Mann Insurance Co., ITT Hartford, Liberty Mutual Insurance Co., New Hampshire Insurance Co., Prudential Property and Casualty Insurance Co., and Southern Family Insurance Co.

<sup>34</sup> These companies were: American Summit Insurance Co., American Superior Insurance Co., Atlantic Preferred Insurance Co., Capitol Preferred Insurance Co., DeSoto Insurance Co., First Protective Insurance Co., Florida Select Insurance Co., Harbor Specialty Insurance Co., Southern Family, Southern Group Indemnity, Inc., Sunshine State Insurance Co., and Universal

*1998 Coastal Countdown Program* - The RPCJUA inaugurated the Coastal Countdown Program in February 1998 in order to specifically depopulate the three counties in which the RPCJUA had a high concentration of personal lines residential policies, namely Dade, Broward and Palm Beach. More than 70 percent of its policies and 81 percent of its exposure were concentrated in those three counties. Increased take-out incentives were offered by the association which included a \$200 per policy bonus for removing Dade county policies; a \$150 per policy bonus for Broward and Palm Beach county policies; and a \$100 per policy bonus for other coastal county policies. In order to qualify for these policy bonuses, insurers were given options to remove at least 5,000 policies pursuant to several options.<sup>35</sup> Soon after the Coastal Countdown Program was implemented, it became evident to the RPCJUA that companies could not meet these policy requirements, thus the association revised the requirements to allow insurers to take-out 1,500 policies from Dade County and 3,500 policies from Broward and/or Palm Beach counties. Companies qualifying for the 1998 Coastal Countdown Program were also eligible for the 3-year, RPCJUA regular deficit assessment exemptions as well as the 3-year FWUA regular assessment exemptions. Pursuant to this program, seven insurers collectively removed approximately 67,198 policies.<sup>36</sup>

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Property and Casualty Insurance Co.

<sup>35</sup> The options were: removing 5,000 policies from Dade, Broward, or Palm Beach county; 5,000 policies from Broward and Palm Beach counties combined, in any combination; or 5,000 policies from Dade, Broward and Palm Beach counties combined, with a minimum of 1,500 policies from Dade County.

<sup>36</sup> These companies were: Desoto Insurance Co., Cypress Property and Casualty Insurance Co., First Protective Insurance Co., New America Insurance Co., Professional Protective Insurance Co., Southern Family Insurance Co., and United P & C.

*General Statutory and Commercial Take-out Programs* - Three insurance companies have opted to remove policies from the RPCJUA and sought only the statutory incentives outlined previously under s. 627.3511, F.S., namely, the \$100 per policy bonus for takeouts of at least 25,000 policies. As of July 1999, these companies have collectively removed 5,261 policies.<sup>37</sup> Additionally, three insurance companies have chosen to remove policies from the association under the commercial take-out provisions which require \$100 million minimum structure exposure and 40 percent of removed policies must be in Dade, Broward and Palm Beach counties, or 30 percent in Dade, Broward and Palm Beach counties and an additional 50 percent from other coastal counties.<sup>38</sup> These companies have collectively removed 610 policies as of July 1999.

*Enhanced Take-out Incentive Program* - In late May of this year, Clarendon National Insurance Company entered into a Consent Order/Agreement with the Department of Insurance wherein the insurer agreed to remove up to 100,000 of the 195,000 policies remaining in the RPCJUA and up to 48,029 policies from the FWUA.<sup>39</sup> In return, Clarendon would receive a \$300 per policy take-out bonus which was higher than the \$100 and \$200 bonuses paid to companies under the previous take-out programs. According to representatives with the Department of Insurance, this large bonus was because all of the policies were in “extremely hurricane-prone areas” and were being assumed right before the hurricane season began (June 1st). Clarendon had initially sought a bonus of \$625 per policy which was rejected. When Clarendon renews the RPCJUA take-out policies, it will be at 3 percent below the current RPCJUA base rate for homeowners policies and 5 percent below the RPCJUA base rate for mobile home policies. Clarendon will assume the FWUA’s existing rates for the wind-coverage policies it removes. Additionally, the company must implement a keep-out program to facilitate placement of at least 10,000 new policies that would otherwise come to the RPCJUA. The RPCJUA is also setting aside a contingency reserve of \$210 per policy which would be paid out to Clarendon only in the event of a major hurricane in South Florida within the next 3 years. The company can access this reserve only if hurricane claims on these specific RPCJUA take-out policies exceed \$22.5 million per year in the next 3 years.

Since the inception of the depopulation program in 1995, the RPCJUA has approved 33 insurance companies to remove more than 1.1 million policies through its take-out programs

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<sup>37</sup> These companies were: Allstate Floridian Insurance Co., Empire Fire and Marine Insurance Co., and Prudential Property and Casualty Insurance Co.

<sup>38</sup> These companies were: Reliance Insurance Co., Southern Family Insurance Co., and Royal Indemnity Insurance Co.

<sup>39</sup> As of July 1999, Clarendon removed 80,795 policies from the RPCJUA and 37,312 wind only policies from the FWUA.

and has ultimately awarded more than \$109 million in bonus moneys to these take-out insurers. The impact on the RPCJUA's exposure statewide has been significant. The association exposure peaked at \$98.2 billion in October 1996, but that figure has been reduced to \$18.4 billion by the end of July 1999, a reduction in exposure of \$79.8 billion in less than 3 years.

Although the RPCJUA had been concentrating on its take-out program for several years, by 1998 it was averaging more than 11,000 new policies each month. In response, the RPCJUA launched two programs during 1998 which were designed to prevent policies from coming into the association. Pursuant to the Voluntary Keep-Out Program, the RPCJUA obtained agreement from twelve insurance companies to agree to write new policies. Then, over 6,000 RPCJUA-appointed agents were contacted and requested to voluntarily submit applications for coverage to these selected companies. These efforts proved somewhat successful and so the association began a second initiative, called the On-Site Keep-Out Program, in which fifteen insurers agreed to spend a week at a time at one of the RPCJUA's five service company locations around the state. These companies would review applications for association coverage and if the insurer chose to offer coverage, the applicant was ineligible for the RPCJUA. Over a 10-month period, these fifteen insurers provided coverage to 5,480 applicants. Additionally, as a result of the two programs, the amount of new business coming into the RPCJUA declined to between 4,000 and 5,000 policies a month.

### **FWUA Depopulation**

The FWUA, unlike the RPCJUA, lacks statutory authority to offer either cash bonuses or exemptions from assessment in its depopulation program. In 1998, the FWUA developed a broad depopulation rule which included both "take-out" and "keep-out" procedures. The Department of Insurance approved the keep-out procedures in January 1998, but still has under review the take-out provisions. Provisions of the take-out rule provide for the following: the FWUA will make available to insurers a list of all association in-force policies; require insurers to take-out the entire policy; require insurers to comply with certain replacement policy conditions including assuming the wind coverage for at least one year following the date the FWUA policy would be renewed; and to submit written proposals to the FWUA.

The FWUA also appointed a special Depopulation Subcommittee last year to develop comprehensive depopulation strategies. In May of this year, Clarendon National Insurance Company became the first company to formally enter into an agreement with the FWUA to remove wind only policies from the association. The insurer assumed 37,312 FWUA wind only policies, with 40 percent of the policies from Monroe, Dade, Broward, and Palm Beach counties. The company made what is referred to as a "me to" filing, which meant that all coverage and terms are the same as the FWUA. As of July 1999, several other insurers have contacted the FWUA about taking out more policies.

Pursuant to the FWUA “keep-out” program, insurance companies provide quotes for coverage of FWUA applicants, and the FWUA then rejects the application for FWUA coverage if the insurer makes an offer to cover a particular property. Under its current keep-out program, four commercial-residential applications have been rejected, accounting for \$28,157,949 in exposure. According to representatives with the FWUA, the keep-out program is expected to keep-out between 10 to 20 applications a week.

## **Availability of Coverage in the Voluntary Market**

The growth pattern of the RPCJUA and FWUA are indicative of the availability of coverage in the voluntary, private market. In most areas of the state, coverage is generally available from authorized insurers. The RPCJUA is writing very little new business outside of Broward, Dade, and Palm Beach counties. In these three counties, however, coverage remains difficult to obtain, particularly in the FWUA-eligible area, east of Interstate 95. Interviews with representatives of the Florida Market Assistance Plan and insurance agents in that area indicate that windstorm coverage with authorized insurers is extremely limited, but is more generally available for high value property and for locations that are least 1,500 feet from the coast, and there is greater availability of coverage from surplus lines insurers. Surplus lines insurers are not required to file policies and rates with the department for approval and there is no guaranty-fund coverage in the event of insolvency.

## **Residential Property Insurance Rates**

Property owners, particularly in south Florida, have experienced significant rate increases since Hurricane Andrew. The Department of Insurance reports that since that time (August 24, 1992), residential property insurance rates have increased 108.5 percent, on a statewide basis, weighted for market share, for the insurers that were the top ten writers in 1994.

In 1996, the FWUA had its first rate increase in 13 years, averaging 31 percent statewide. In 1998, the FWUA obtained an average statewide increase of 12 percent, as determined by an arbitration panel after the FWUA had filed for a 61 percent increase to be phased in over a 3-year period, that was disapproved by the department. A new rate filing was filed by the FWUA in May 1999, which was disapproved by the department. The FWUA has filed for arbitration of the rate filing, which is pending. The FWUA rate filing would increase rates by a statewide average of 128 percent, with a maximum annual increase of 40 percent. The filing is based on all five models approved by the Florida Commission on Hurricane Loss Methodology, which generally varies rates by distance from the coast. The filing also provides premium credits for homes that meet or are retrofitted to meet certain construction design standards that mitigate against hurricane losses, so that the rate increase would be in the 60-80 percent range if a policyholder meets these standards. Insurance representatives have alleged that inadequate FWUA rates are a major contributing factor to the FWUA’s policy count and exposure, and discourages companies from taking policies out of the FWUA given the department’s current policy of requiring take-out insurers to charge rates

that are comparable to the rates of the FWUA and the other peril insurer.

The Department of Insurance was asked to provide a rate comparison to the committee (Appendix A). The rate comparison shows the hurricane rate and the non-hurricane rate (which must be separately identified by insurers) in Dade, Broward, Palm Beach, and certain other counties, for the FWUA, RPCJUA, State Farm, Allstate Floridian, and the two insurers that charge the highest and lowest rates among the top eighteen writers in those counties, for homes valued at \$75,000, \$150,000, and \$300,000 with hurricane deductibles of \$500 and 2 percent of policy limits.

Shown below in Table 8 are the rate comparisons for a \$150,000 home (masonry construction), with a 2 percent hurricane deductible, in Dade, Broward, and Palm Beach counties. (See Appendix A for all rate comparisons provided by the department and the cover memo explaining factors considered.)

**Table 8**

**HO-3 Rate Comparison Highest/Lowest Hurricane Rate of Top 18, State Farm, Allstate, FWUA, and FRPCJUA**

<b>\$150,000 Masonry Construction, Town Class 4, \$500/2% Deductible</b>				<b>H0-3 Policies in Force as of (3/31/99)</b>		
<b>BROWARD COUNTY</b>	<b>HURRICANE</b>	<b>NON-HURRICANE</b>	<b>TOTAL</b>	<b>BROWARD COUNTY</b>	<b>WIND</b>	<b>X-WIND</b>
Allstate Floridian	\$1,381	437	\$1,818	Allstate Floridian	19,415	4,949
State Farm	1,147	525	1,672	State Farm	57,925	16,043
Florida Farm Bureau General	(High)1,687	674	2,361	FL Farm Bureau General	311	35
Prudential	(Low) 422	1,066	1,488	Florida Family Mutual	57	1,466
FWUA (No Appurtenant Structure)	802	48	850	Prudential P&C	3,556	786
FWUA (w/\$15,000 Appurtenant Structure)	1,490	85	1,575	FWUA (as of 6/30/99)	60,165	0
FRPCJUA	934	1,235	2,169	FRPCJUA	45,346	184
<b>\$150,000 Masonry Construction, Town Class 4, \$500/2% Deductible</b>				<b>H0-3 Policies in Force as of (3/31/99)</b>		
<b>DADE COUNTY</b>	<b>HURRICANE</b>	<b>NON-HURRICANE</b>	<b>TOTAL</b>	<b>DADE COUNTY</b>	<b>WIND</b>	<b>X-WIND</b>
Allstate Floridian	\$1,742	585	\$2,327	Allstate Floridian	13,254	3,874
State Farm	1,260	608	1,868	State Farm	52,583	14,692
Florida Farm Bureau General	(High) 2,352	904	3,256	FL Farm Bureau General	364	93
Prudential	(Low) 507	1,295	1,802	Prudential P&C	7,487	2,054
FWUA (No Appurtenant Structure)	865	47	912	FWUA (as of 6/30/99)	68,412	0
FWUA (w/\$15,000 Appurtenant Structure)	1,554	84	1,638	FRPCJUA	71,506	465
FRPCJUA	1,089	1,493	2,582			

*Availability and Cost of Residential Hurricane Coverage*

<b>\$150,000 Masonry Construction, Town Class 4, \$500/2% Deductible</b>				<b>H0-3 Policies in Force as of (3/31/99)</b>		
<b>PALM BEACH COUNTY</b>	<b>HURRICANE</b>	<b>NON-HURRICANE</b>	<b>TOTAL</b>	<b>PALM BEACH COUNTY</b>	<b>WIND</b>	<b>X-WIND</b>
Allstate Floridian	\$1,352	264	\$1,616	Allstate Floridian	10,458	2,229
State Farm	1,114	401	1,515	State Farm	44,857	15,632
Florida Farm Bureau General	(High)1459	584	2,043	FL Farm Bureau General	546	33
Prudential	(Low) 368	936	1,304	Prudential	4,679	1,105
FWUA (No Appurtenant Structure)	734	49	783	FWUA (as of 6/30/99)	46,806	0
FWUA (w/\$15,000 Appurtenant Structure)	1,423	86	1,509	FRPCJUA	26,329	318
FRPCJUA	826	1,068	1,894			

Source: Florida Department of Insurance

The FWUA provides windstorm coverage only, so the most relevant comparison is between the hurricane rates for the FWUA with the hurricane rates of other insurers. However, the FWUA charges a separate premium for appurtenant structure coverage for screened enclosures, which makes the comparison difficult. The FWUA reports that only 3 percent of their policyholders elect to purchase appurtenant structure coverage, which results in a much higher additional premium than would be charged if it were included in all policies. Most other insurers include this coverage as part of its standard policy, but State Farm’s hurricane endorsement in five territories, including Dade, Broward, and Palm Beach Counties, excludes coverage for detached buildings, awnings and patio covers.

With these factors in mind, in Dade County, the hurricane rate for the FWUA *with* appurtenant structure coverage is \$1,554, which is lower than the \$2,352 rate for the highest priced insurer (Florida Farm Bureau), and lower than the \$1,742 rate charged by Allstate Floridian, but higher than the \$865, rate charged by State Farm and the \$507 rate of the lowest priced insurer. However, the FWUA rate *without* appurtenant structure coverage is \$1,150, which is lower than all the other insurers except the lowest priced insurer. This pattern holds true for Broward and Palm Beach counties, as well, as shown on Table 8.

## **Conclusions and Recommendations**

The current exposure and expected losses of the FWUA creates a likely possibility that significant assessments will be imposed on all property insurance policyholders if this exposure is not reduced. The Legislature and the Department of Insurance should consider options to reduce the exposure of the FWUA in a manner that does not unfairly impact FWUA policyholders. Options for reducing the exposure of the FWUA include the following:

- Specifying the standards and procedures that must be followed if an insurer makes an offer of coverage that would disqualify a policyholder from maintaining FWUA coverage, including adequate notice to the policyholder, agent, and other peril insurer; providing the other peril insurer with the option of writing the windstorm coverage; and authorizing the department to approve the take-out insurer's financial capacity to meet its obligations.
- Eliminating or reducing coverages that are not typically covered under a standard homeowners policy, such as tiki huts and gazebos;
- Limiting coverage for personal lines residential risks to a specific value, such as \$1 million, if a determination is made that such coverage is generally available from authorized insurers or the surplus lines market.

The current law requires that rates for the FWUA be actuarially sound and not be competitive with approved rates charged in the admitted voluntary market. The law also provides the FWUA board with the option for arbitration of a rate filing that is disapproved by the department, and provides that hurricane loss projection models are admissible and relevant in a rate hearing if they have met the standards approved by the Florida Commission on Hurricane Loss Methodology. These standards and procedures should be sufficient to address concerns regarding the adequacy or excessiveness of the FWUA rates.

The Legislature should consider imposing an outside limit on the annual liability of the FWUA to its policyholders, comparable to the practical limits imposed on policyholders of authorized insurers. The limit could be equal to the estimated probable maximum loss for a 100-year storm (currently \$5.3 billion), as annually determined by the board and the department, with a minimum guarantee of \$300,000 per claim and pro rata reduction of claims beyond this limit. Under current law, after a major hurricane, the FWUA will be forced to use the debt financing that it has secured (which is \$5.3 billion for 1999, equal to its current 100-year storm estimate) and if that is not sufficient, attempt to issue revenue bonds or other means of additional debt financing to pay its contractual obligations to policyholders. Such additional financing may not be available or would, at best, carry high interest rates and debt service. This potentially unlimited liability would be borne by all policyholders in the state. Alternatively, failure of the FWUA to aggressively pursue and obtain debt financing for the full extent of its liability could lead to lawsuits against the association and the state. The FWUA board has followed a policy of securing debt financing sufficient to cover its estimated 100-year storm loss. Similarly, the Department of Insurance requires an insurer to have surplus and reinsurance to cover its estimated 100-year storm

loss, as a condition of approval to take policies out of the RPCJUA or FWUA. If a storm loss exceeds this amount and an authorized insurer becomes insolvent, the Florida Insurance Guaranty Association guarantees payments of policyholder claims, but only up to \$300,000 per claim. For condominium association policies, the limit is \$100,000 multiplied by the number of units. FWUA policyholders should be assured of these same minimum recoveries, but not more, and should face the same risk of “insolvency” as voluntary market policyholders. Since the FWUA cannot technically become insolvent, it would be equitable to its policyholders to impose an outside limit on the FWUA’s liability equal to the 100-year storm financing that financially sound voluntary insurers are expected to obtain.

The Legislature should consider requiring authorized residential property insurers to maintain adequate surplus and reinsurance to cover their estimated probable maximum loss for a 100-year storm, as estimated by at least one of the models meeting the standards approved by the Florida Commission on Hurricane Loss Methodology. Despite the fact that this standard is generally accepted by insurance rating organizations and required by the Department of Insurance as a condition of approval for insurers taking policies out of the RPCJUA or FWUA, it is not a statutory requirement for all residential property insurers.

The Legislature should consider amending the definition of *hurricane coverage* to provide a more specific determination of when a hurricane deductible applies. One option is to require that the damage occur in a county in which the Division of Emergency Management of the Department of Community Affairs, based upon official forecasting information from the National Weather Service, declares that an area in the county sustained winds that were part of the storm system.

# Appendixes